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ST. LOUIS, MISSOURI

ON THE

EXPANDING ROLE OF ACCOUNTING IN OUR ECONOMY

JUNE 18, 1979

Good morning ladies and gentlemen.

I would like to share with you today some thoughts as to why the role of accounting is expanding and what some of the problems are that we have to face as a result.

WHAT PRESSURES SEEM TO BE CAUSING EXPANSION  
IN THE ROLE OF ACCOUNTING IN THE ECONOMY

[ Numerous pressures in the economy today are causing people to want more and better accounting information. The one that comes to mind first, of course, is inflation. ] For many years inflation progressed at such a slow pace that most people were willing to accept accounting data based on current dollars without worrying about the small diminution in the value of the dollar which took place from one year to another. How different things are today. The pace of inflation has quickened bringing with it a chorus of cries

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for accounting data that is more in tune with economic reality. [Investors and others in the business world are turning to accountants and asking for new information on profits--not just how many dollars were made--but [how much was earned in terms of purchasing power. ] They also want to know what changes have occurred in the real value of assets and liabilities. ]

Government is feeling some of this pressure also. I will let you decide just how "Proposition 13" and other similar [movements relate to inflation], but the fact is, these movements include a challenge for accountants. Inherent in these movements is a desire both for greater efficiency in Government and for accountants to provide more information. The traditional lists of expenditures will not satisfy people involved in these movements. They [are challenging accountants to show precisely how efficiently, economically, and effectively the business of Government is carried out --not just how much is spent for what function. ]

[Another pressure being exerted on accountants is to find ways to provide better protection against fraud and abuse. ] We have always prided ourselves on being a moral country. We expect our citizens to be honest, our business leaders to be honest, and our Government officials to be honest. Unfortunately, events of recent years have caused us to question those expectations. Equity Funding and Penn Central opened the way to a host of other revelations of either

corporate wrong doing or a lack of accounting procedures that realistically described the situation. Then Watergate surfaced and with it came revelations not only of misdeeds at the highest levels of our Government but of laundered money and unbelievably poor accounting practices in the handling of campaign funds. No sooner had the furor over Watergate begun to die down than we were again shocked by revelations of corporate bribery of foreign officials and extensive fraud in the General Services Administration.

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All of these instances of misconduct have brought a great hue and cry to eliminate fraud and abuse from our national life; and that response is pressuring <sup>in my personal</sup> [accountants to expand their internal control work to see that if fraud and abuse cannot be eliminated], at least it will be made as difficult as possible to accomplish.

[The computer is another factor enlarging the accountant's role. Computers produce data in such volume that questions that went unanswered before for lack of data, can now be answered. ~~It~~ The challenge to accountants is how to structure this data in ways that managers can understand it and deal with it intelligently.] Unfortunately, much of the output of computers is still too detailed for maximum usefulness to top managers. Accountants need to use their skills to change this.

Another area presents some pressures to expand the role of accounting; however, those pressures are not as

great as I think they should be. As many of you know, [the rate of improvement in productivity in the United States has declined in recent years. If we are to continue to increase our standard of living as we have done in the past, we need to have a greater increase in the productivity of our work force.] If productivity does not increase, any salary increases are inflationary. The pressure on accounting is to better measure our productivity and, by analyzing accounting data, identify areas in which productivity can be improved.

Those are some of the main pressures that seem to be calling for an expanded role for accounting in the economy. There are doubtless others.

#### WHAT CHANGES ARE RESULTING FROM THE EXPANDING ROLE OF ACCOUNTING

Next, I would like to discuss the change in accounting practices that I see resulting from these pressures. Harbingers of most of these changes have already arrived so most of them are not new. They are, however, some of the major challenges accountants will face in the next few years. Since members of this group here today are either employed by Government or have close interests in Government, I want to relate these challenges principally to their effect on Government.

#### Current Value Accounting

[Recently, current value accounting or some variation of it which would adjust financial statements for the effects

of inflation and changing prices, has gained greater attention. ]

← The Financial Accounting Standards Board (FASB) is considering what action to take. It has issued an exposure draft which would require supplementary disclosure of such information and just recently held 3 days of public hearings in New York. The FASB expects to issue a final standard before the end of September. The Securities and Exchange Commission (SEC) currently requires certain large public companies to disclose replacement cost data in their financial reports. These are the beginnings of changes which I think will lead to accounting reports being more realistically stated. 199

Few will contend that this is not a desirable goal; the question is how to get there; a methodology that is acceptable is difficult to find. This obstacle must be overcome before current value accounting can become a reality but it is the direction in which we are headed and in a few years will be commonplace to have such disclosure accompany the financial statements and eventually perhaps be the basis on which such statements are prepared.

Current value accounting probably will not be instituted in Government as rapidly as in the private sector. Although investors generally have not yet indicated a great interest in current value data, they seem to place more importance on financial information when buying private sector securities than when buying public sector ones. Therefore, I believe such data will be used sooner in the private sector.

I might add that I served as a member of the advisory committee that helped the Treasury Department set up plans <sup>39</sup> for the Consolidated Financial Statements for the U. S. Government. In our discussions of these statements, we concluded that current value information would be very useful in obtaining a proper perspective of the financial situation of the U. S. Government; accordingly, we opted to include such data to the extent possible. I believe other governmental organizations will ultimately adopt the idea too, but at a slower rate than organizations in the private sector.

MORE MEANINGFUL ACCOUNTING PRINCIPLES  
AND STANDARDS ARE BEING DEVELOPED

The concern with accounting standards in recent years is unprecedented. A tidal wave of criticism of financial reporting engulfed the accounting profession as a result of a series of events beginning in the late sixties. Much of the criticism was focused upon the Accounting Principles Board. This led to the establishment of the Wheat Committee and subsequently the creation of the FASB in 1973 as an independent organization for the express purpose of prescribing accounting standards for commercial entities. Although the jury is still out as to whether or not this effort will be successful, I believe the verdict will be that it is.

The concern over accounting standards has spread to the governmental sector as well. The crisis in New

York City was in part attributed to the accounting practices they followed. The City did not follow the principles prescribed in GAAP for municipalities. The principles that were adopted tended to anticipate revenues and to recognize expenditures late, thus making the financial picture look rosier than it was. The advocates of "Proposition 13" and similar actions have also sparked a desire for better accounting principles for governments-- principles that will make it easier to understand where the government gets its money and what is accomplished with it.

Principles for State and local government accounting cannot be the same as for commercial accounting because each have different goals. Industry's basic objective is to make a profit. True, it has a host of other lesser objectives but the fundamental one is to make a profit.

Government, on the other hand, is not in the business of making a profit. It operates mainly through programs established by legislative bodies, and its managers are charged with the responsibility for assuring that the programs accomplish their objectives. They should also be concerned with keeping their costs down and not exceeding their authorized spending levels, but this is not the same thing as making a profit. Consequently, except for some of the business-like activities Government performs, accounting aimed at measuring profits is not suitable for

governments.

At this point I would like to comment on a question that is often posed to me: Should Federal accounting principles be the same as those for State and local government? My answer is always the same--I hope so, but I am not sure. Certainly there are similarities. The qualification is necessary because of the considerable differences in functions between the Federal Government and State and local governments. The Congress has given GAO the responsibility for setting the accounting principles that Federal agencies shall follow and we intend to set principles that will serve the Congress, Federal managers, and citizens as effectively as possible. We are now developing our own conceptual framework for the Federal Government and it will be followed by a revision of the accounting principles we have established for Federal agencies. We plan to follow closely what is done by the National Council on Governmental Accounting and others D 4635 involved in establishing State and local conceptual frameworks and in setting accounting principles. It is our hope that if we have differences, they will be based on an identified need. However, we recognize that the Federal Government is, in many respects, a unique entity and we are prepared to prescribe differences when they are clearly called for.

When these various principles have been established, I believe that accounting information that is issued by



governmental organizations will be of greater use to investors, decisionmakers, and citizens.

Accountants Need to Help Control Fraud and Abuse

I think we will all agree that the area of fraud and abuse has gained increased visibility in recent years. Some believe that fraud and abuse first surfaced during the investigations that took place after Watergate, when it became clear that many corporations had made questionable or illegal payments. These problems, combined with such fraudulent activities as the Equity Funding Scandal, have made the public, the Securities and Exchange Commission, and some members of the Congress critical of the role of the auditing profession in failing to prevent and detect such irregularities.

Fighting fraud and abuse requires close cooperation of law enforcement officials, accountants, and auditors. With such cooperation, perpetrators of fraud and abuse can be caught and punished. The punishment of one offender tends to discourage other potential offenders.

However, punishment of offenders alone is not the answer.

[What is needed is vastly improved internal control systems that make fraud and abuse difficult to accomplish.] Many offenders commit fraudulent deeds simply because it is so easy.

There is considerable interest in improved internal

financial controls in the private sector. Several responsible organizations--including the AICPA's Commission on Auditors' Responsibilities (the Cohen Commission)--have strongly suggested that corporations be required to report on the adequacy of their internal control systems. This might take the form of reports issued by the audit committee, the chief financial officer, or the director of the company's internal audit organization.

Recently, Price Waterhouse issued a document entitled, Enhancing Government Accountability. This document urges all governmental units to develop programs to evaluate the adequacy of their internal accounting control systems. Each unit would issue an "Executive Report" signed by the unit's chief executive reporting on the extent and adequacy of internal controls and indicating his acceptance of responsibility for the statements. We in GAO are in favor of such a reporting.

I believe it is now a virtual certainty that in the not too distant future reporting on internal control will be a reality for companies having publically held stock. Both internal and external accountants and auditors will be involved in this process.

No one knows the magnitude of fraud and abuse against the Federal Government but it is of serious proportion and heroic efforts are warranted to reduce it. The seriousness

of this problem led the Congress last October to create a dozen Offices of Inspector General in major departments and agencies to prevent and detect such activities. At GAO we have established the Special Task Force for the Prevention of Fraud. The major responsibilities of this group are first, to evaluate the adequacy of Federal agencies' management control systems, which are necessary for the prevention of fraud; and second, to assess the adequacy of followup and corrective actions taken on recommendations made in reports by Federal agency auditors and investigators. It is our belief that where management control systems are properly developed and are functioning as planned, the possibility of fraud, theft, or error is greatly diminished. Conversely, where the systems do not exist or are not being used properly, the opportunities to defraud the Government and the possibilities of error increase dramatically.

[ We are making fraud prevention--not detection--our top priority. ] Our work will concentrate on strengthening control weaknesses in agency systems that permit fraud to occur. As we uncover potential fraud and abuse, we will be looking for patterns that could occur and can be explored in other agencies. ]

Another action [ we have ] taken is to [ set up a toll-free telephone number which affords concerned citizens nationwide an opportunity to report instances of suspected fraud to the

Task Force for investigation and possible prosecution.]

To date, the "hotline" has produced thousands of leads, involving instances of apparent mismanagement or intentional wrongdoing. These include theft, private use of Government property, improper financial transactions, bribes, kickbacks, and extortions.

Accountants Need to Use  
Computers More Effectively }

Computers now operate in nanoseconds, which is one-billionth of a second--so fast that it literally defies comprehension. At these speeds they can turn out vast quantities of data. The problem is that much of the data the computers turn out is not summarized sufficiently to be meaningful to managers. The challenge that has yet to be met is making maximum use of the computer's fantastic computational capability to summarize data, zero in on problems, and highlight for management what needs to be done.

The manager's job, basically, is to achieve goals at the least practicable cost, to make the best possible use of the resources entrusted to him or her, and to stay within spending and other limitations. <sup>NT</sup>To do this,

(managers need timely, complete, and accurate information on

- legal limits and resources,
- obligations and costs incurred and their

relationship to budgeted amounts,  
--work goals achieved and their cost,  
--the degree to which work goals are met, and  
--opportunities to achieve goals at a lower  
cost. )

To be useful, the information must be tailored to the needs of managers at different levels in the organizational hierarchy. ) This is where [the accounting system] comes into play. It {should serve the information needs of each level of manager in the agency by isolating particular information so that each manager is not burdened with extraneous information. )

I would like to relate a few examples of how accounting systems--especially computerized systems--failed to give managers the right information at the right time or simply burdened the manager with pages of unneeded details.

One agency's computerized accounting system produced about 15 basic reports--it literally flooded the management with data. Computer center officials estimated that they distributed 10 and 1/2 tons of paper in a year in the form of computer printouts. Among the reports, as could be expected, there was duplication of data. There was also excessive detail--some reports included complete details of all transactions when only summary data was needed--and complexity--some of the reports were difficult to understand, so management did not use them.

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Another agency produces a report which shows salaries paid during the month. Summarized data on salary costs is included in other reports produced by the agency. As a result, managers do not use the detailed report; it is usually just thrown away. That report costs about \$14,700 annually to produce.

In another instance, a small office of a large agency received a 2,000-page report which included more than 15,900 allotment balances. But only 380 of these balances pertained to that office's operations. Other offices of this agency experienced similar problems--that is, they were swamped with hundreds of pages of extraneous information.

The problems I have cited are virtually the same in both the public and private sectors. Accountants need to devote more effort to shaping computer systems to produce reports that highlight problems and clearly call for management action.

Better Cost Accounting Can Help  
Improve Productivity

At this point, I would like to touch upon the need to improve the Federal Government's productivity and the role played in this area by accounting systems. National productivity growth has long been recognized as a key factor in both controlling inflation and promoting economic well being. Yet the value of productivity improvement in the

Government sector has been largely ignored.

{The benefits to be derived from improved efficiency of the Federal work force are enormous.} If overall productivity could be increased by an additional one percent, 29,000 fewer employees would be needed to provide the present level of Government services. Therefore, {by increasing productivity, managers and policymakers are afforded the opportunity to both increase public services and to reduce taxes.}

To improve productivity requires management action based on reliable information. {Cost accounting systems, in conjunction with performance measurement systems, provide this basic information and enable Government managers to

--assess organizations' productivity performance,  
and

--identify where action is needed to improve  
productivity.}

{When a work or performance measurement system is integrated with an accurate time and cost reporting system, efficiency of operations is measurable.} Productivity, in turn, can be expressed in terms of efficiency, hopefully, for the better.

In organizations where productivity improvement is lagging, {cost accounting systems provide management with the tools needed to seek out changes that will improve

productivity.} Unit cost information can be a primary management tool for appraising resource utilization, comparing different operations, and analyzing personnel requirements. It can be used by managers to compare the resources used with targets of what should have been used. The variances can be interpreted as a measure of success or failure or as an indicator that resource utilization has been good or bad.

Despite the benefits of such data and the fact that OMB Circulars A-11 and A-44 indicate a need for unit costs, {we have found few agencies that record costs for their basic units of work.} For example, in a study of 26 Federal organizations providing data processing services, none had fully adequate cost information on the automatic data processing assets or operations.

This lack of information is the rule, not the exception. We believe that holding Federal managers accountable for the efficient use of people and other resources will continue to be difficult until performance goals are clearly articulated, mutually understood, and used in the process of judging the performance of managers. Systems such as work measurement and cost accounting need to be used as tools to set performance goals and show how efficiently Federal managers use people and other resources.

One facet of productivity improvement is the cost of Government regulations. Most of us would agree that many



of the regulations are necessary and have a positive effect on our lives. However, we all know that some regulations are duplicative or are not coordinated with other closely related regulatory activities. We, in GAO, have an effort underway in this area which I would like to tell you about. Federal regulatory agencies have the authority to prescribe accounting systems to be followed by the business community under their jurisdiction. These agencies have been reluctant to develop a single uniform accounting system to which all regulatory agencies would prescribe subject, of course, to industry variations.

Our Office has been concerned for some time about the inconsistencies in the accounting rules issued by these agencies. Because of this concern, we have established a special group which has initiated a number of assignments designed to focus on the agencies' financial accounting and reporting requirements and their related uses.

This effort, as well as those of other organizations, will cause the <sup>with intent</sup> agencies to move toward making uniform those financial accounting and reporting requirements that are placed on the "regulated" sector of our economy. This will permit greater consistency in both accounting and financial reporting requirements and will, in turn, reduce the compliance burden on those who must comply with the requirements and assist the investor in his analysis of

the regulated enterprises.

### CONCLUSION

In summary, the role of accounting will expand significantly in the next few years.

[--Accountants will be called on to "account" for the effects of inflation and changing prices.

--Accounting standards including those of regulating agencies will be developed that will result in more consistent and more easily understood financial statements.

--Internal control will become far more important and auditors will devote more time to it.

--Procedures to detect fraud and abuse will expand the auditor's role.

--New accounting and auditing techniques will be developed to get more useful information out of the computer, and

--Better cost accounting will be needed to identify causes of productivity decline and permit appropriate action.)

All this will mean that accountants and auditors must roll up their sleeves and be prepared to do more than they have done before. They also must be receptive to change

for that will be the order of the day. They must be receptive to "soft" accounting data and the techniques of auditing such data.

The problems facing the profession today are far more complex than at any other time in the profession's history. We needed good accountants in the past, but we need them even more today and in the future.

The profession needs people who care deeply about its workings and who agree that the profession will succeed only as long as it is able to attract and inspire good people. This means that the people must be dedicated and willing to do that "something extra" to make the profession better.

It seems certain that in order to meet these new challenges the professionals of the future will have to be better educated. Not only in accounting but other areas as demand requires. Accounting will probably require advanced training much like the legal profession does today. Accountants will have to be much more proficient, for example, in data processing since virtually all transactions will be handled electronically. Perhaps some training in fraud prevention and detection will become a standard part of the accounting curriculum. Whatever the additions, I feel assured that the Association of Government Accountants will increase its involvement in the educational effort of the accounting profession. Your efforts will be greatly needed.

Finally, I would like to offer a "thanks" and at the

same time a challenge to the members of the Association of Government Accountants. Recently, the Association offered its assistance in developing standards for a proposed report by executive officers of Government that will deal with the adequacy of internal controls within their agencies. The Association has also recently established a Committee on International Affairs. You are to be commended for initiating such efforts. However, I believe you as an association and as individuals can and must do more. Accordingly, I challenge all of you to direct the research of the Association toward formulating solutions to the problems I have addressed today and others as they arise. We in the General Accounting Office pledge our full support to this effort and will do all within our resources to seek the solutions.