

JOSEPH DIOGUARDI/MICHAEL GRANOF

# Truth in spending needed for budget to be balanced

As certified public accountants, and as a former member of Congress and a professor of accounting, respectively, we firmly believe that the federal budget debate is avoiding the key issue that will ultimately determine our nation's capacity to prevent fiscal disaster. Even the balanced budget amendment does not address the issue. Once passed into law, its stipulations can be dodged altogether because of the egregious budgeting and accounting inadequacies tolerated by the House of Representatives and the Senate.

We cannot balance the budget without meaningful and reliable financial data. The current budget debate is missing the point because the underlying accounting numbers are invalid. The figures are based on accounting principles that capture only a portion of the cost of federal activities, and they are so misleading that they would be rejected out of hand if submitted to the Securities and Exchange Commission by a private-sector, publicly traded corporation.

Based on the principles used to prepare its budget for the fiscal year ended Sept. 30, 1993, the federal government determined its actual operating deficit to be \$225 billion (\$203 billion for 1994). However, in its audited financial statements for 1993 (the latest year for which statements have been issued, itself a commentary on the federal accounting system), the U.S. government using "generally accepted accounting principles" (GAAP), reported a deficit of \$386 billion. The difference — a "mere" 51 percent — results because the budget is constructed on a cash basis, whereas the financial statements are prepared on a more meaningful

GAAP basis. Thus, for example, while the budget ignores the pensions earned by federal employees until they retire, the financial statements recognize them as an expense (and a liability) as they are earned.

Furthermore, the conventional measure of the federal debt — that held by the public and focused on by the government — was \$3.2 trillion as of year-end 1993. This contrasts with \$5.2 trillion as reported in the latest audited financial statements. But even this amount, which incorporates accounts payable and accrued civil service and military pension obligations, still greatly understates the government's actual financial liabilities. It excludes the total unfunded actuarial liability for Social Security of \$7.6 trillion and unrecorded Medicare obligations in the amount of \$3.6 trillion. In addition, it excludes contingencies, such as loan and credit guarantees and potential obligations under insurance programs, that add up to another \$5.9 trillion. The differences between the audited amounts and those relied upon by Congress are likely to be even greater for 1994 and 1995.

To make matters worse, the audited financial statements themselves cannot be relied upon. In a report on the 1993 statements, Arthur Anderson & Co., the "big six" CPA firm, concludes that deficiencies in both accounting principles and information systems "make it likely that the [consolidated financial statements are] materially misstated." The message is

confirmed in embarrassing detail in several General Accounting Office studies, which disclosed the following:

- Although the Defense Department is accountable for more than \$1 trillion in assets, its financial management system "is the worst in government and is the product of many years of neglect." Even after \$400 billion of accounting errors were corrected for fiscal years 1991 through 1993, the financial statements were still not reliable;

- The Internal Revenue Service and Customs, sister agencies in the Treasury Department, collect \$1.25

trillion per year. Yet their financial systems are so antiquated that they cause "bookkeeping problems IRS would not accept from taxpayers." A 1993 audit found unreliable data on an estimated \$71 billion of accounts receivable and more than \$90 billion in transactions that had not been posted to taxpayers' accounts.

An additional, if only symbolic, reason to lament the current budget debate is another "Big Six" accounting firm's recently released audit report on the House of Representatives' own 1994 financial statements. Price Waterhouse & Co. concluded that the House

"lacks the organization and structure to periodically prepare financial statements that, even after significant audit adjustment and reconstruction, are accurate and reliable." Its accounting systems, the report added, are "simplistic and ill-suited for an organization the size of the House." How can one take seriously the fiscal forecasts of a government ruled by a Congress that cannot keep its own "House" in order?

To its credit owing in large part to the 1990 Chief Financial Officers' Act and the establishment of the Federal Accounting Standards Advisory Board (FASAB), the Clinton administration is taking sound steps toward bringing the government's financial accounting systems and practices into the modern era. But the improvements will come too late to provide the data required for an informed budget debate, certainly during this year, and perhaps for years to come. In the meantime, the unreliable — and indeed biased — financial reports can only obscure and compound the nation's fiscal problems.

We believe it is time for the government to hold itself to the same standards of accountability to which it holds officers of publicly traded corporations, through the Securities and Exchange Commission, and to which it holds taxpayers, through the IRS. The most important step in stopping fiscal profligacy at the federal level is for Congress to mandate sound accounting principles, standard amounting systems, and indepen-

dent audits, and to acknowledge the full extent of our deficits and our debt.

A good start would be for Congress to pass immediately S. 1130, the Accounting Standardization Act, which was recently introduced by Sen. Hank Brown, Colorado Republican, the only CPA currently serving in the Senate. This bill mandates the use of federal accounting principles, as promulgated by the FASAB, and calls for a standard accounting system and use of standard ledgers throughout the federal government. The bill's enactment would be an important first step in telling the public what government is doing with our tax dollars.

Thomas Jefferson believed that every American "should be able to comprehend [the nation's finances], to investigate abuses, and consequently to control them." He had the right idea. Unless the people can control their government, it is no longer theirs. And until the government is made to account honestly, fairly, and openly for what it does with the money it spends today and holds for the future, the government is not under the control of the people and a balanced budget is an illusion.

Joseph J. DioGuardi is a former member of the U.S. House of Representatives from New York. Michael H. Granof is a professor of accounting at the University of Texas at Austin.

