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THE EXAMINATION OF SEVERAL FACTORS THAT  
HINDER THE IMPLEMENTATION OF STATE GOVERNMENT  
ACCOUNTING PRINCIPLES.

THE UNIVERSITY OF NEBRASKA - LINCOLN, PH.D.,  
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THE EXAMINATION OF SEVERAL FACTORS THAT HINDER  
THE IMPLEMENTATION OF STATE GOVERNMENT  
ACCOUNTING PRINCIPLES

by

Richard L. Hodges

A DISSERTATION

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Business Administration

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Lincoln, Nebraska

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**TITLE**

The Examination of Several Factors that Hinder the Implementation  
of State Government Accounting Principles

**BY**

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## TABLE OF CONTENTS

CHAPTER	PAGE
I. DEVELOPING ACCOUNTING PRINCIPLES FOR STATE GOVERNMENT . . .	1
Introduction. . . . .	1
Accounting Principles . . . . .	1
Principles Development. . . . .	2
Background. . . . .	2
Present-Day Organizations . . . . .	4
Financial Accounting Standards Board. . . . .	4
National Committee on Accounting Principles of the Council of State Governments . . . . .	7
National Committee on Governmental Accounting. . . . .	8
Committee on Concepts of Accounting Applicable to the Public Sector 1970-71 . . . . .	9
Financial Management Standards Board-- Government Accountants Association. . . . .	13
General Accounting Office . . . . .	15
American Institute of Certified Public Accountants Committee on Governmental Accounting and Auditing . . . . .	18
Summary . . . . .	20
II. STUDIES OF THE APPLICATION OF ACCOUNTING PRINCIPLES . . . .	23
Introduction. . . . .	23
Overview. . . . .	23
Coopers and Lybrand--The University of Michigan . . . . .	26
Accounting Basis. . . . .	27
Liabilities . . . . .	28
Fixed Assets. . . . .	30
Other Studies . . . . .	31
Conclusion. . . . .	35
III. FACTORS THAT MAY PREVENT THE APPLICATION OF GOVERNMENT ACCOUNTING PRINCIPLES . . . . .	38
Politicians Do Not Favor Disclosure . . . . .	41
Frequent Changes in Agency Top Management . . . . .	43
The Failure of Accountants to Convince Agency Management That Better Accounting Is Worthwhile . . . . .	44
Congressional Mandates. . . . .	46
Members of the Legislature Lack Business Experience . . . . .	48
Lack of Involvement by Accountants. . . . .	49
Need to Collect Additional Information. . . . .	52

## CHAPTER

PAGE

Activities Are Carried Out by Autonomous Departments . . . . .	56
Method of Selecting an Auditor. . . . .	58
Lack of Follow-up . . . . .	61
Lack of Qualified Personnel . . . . .	65
Accounting Does Not Measure Government Operations Properly . . . . .	66
 IV. RESPONSES OBTAINED FROM SURVEY OF STATE ADMINISTRATORS AND STATE LEGISLATORS . . . . .	 69
Introduction. . . . .	69
Methodology . . . . .	70
Survey Results. . . . .	76
H <sub>1</sub> Politicians Do Not Favor Disclosure. . . . .	76
H <sub>1a</sub> Special Interest Groups Do Not Favor Disclosure. . . . .	76
H <sub>1b</sub> Legislators Do Not Favor Disclosure. . . . .	79
H <sub>1c</sub> State Executive Branch Administrators Do Not Favor Disclosure . . . . .	80
H <sub>1d</sub> Voters Cannot Hold Legislators Account- able for the Financial Impact of Their Decisions . . . . .	81
H <sub>1e</sub> Impact of Politicians' Desire to Disclose on Accounting System Devel- opment Is Minor . . . . .	83
Conclusion: H <sub>1</sub> Politicians Do Not Want to Disclose . . . . .	83
H <sub>2</sub> Failure to Convince Management of the Need for Improved Accounting . . . . .	84
H <sub>2a</sub> Political Considerations Are More Important than Financial Considerations . . . . .	84
H <sub>2b</sub> Financial Improvements Needed Are too Expensive Relative to Benefits. . . . .	86
Conclusion: H <sub>2</sub> Failure to Convince Manage- ment of the Need for Improved Accounting. . . . .	87
H <sub>3</sub> Legislative Mandates Set without Reference to Needs for Accounting Information Hinder the Implementation of Improved Principles . . . . .	88
Conclusion: H <sub>3</sub> Legislative Mandates Set without Reference to Needs for Accounting Information Hinder the Implementation of Approved Principles. . . . .	91
H <sub>4</sub> Legislators Lack the Business Experience Needed to Understand the Problems in State Government Accounting . . . . .	91

Conclusion: H <sub>4</sub> Legislators Lack the Business Experience Needed to Understand the Problems of State Government Accounting. . . . .	95
H <sub>5</sub> Accounting as a Profession Is not Adequately Involved in State Government Accounting . . . . .	95
Conclusion: H <sub>5</sub> Accounting as a Profession Is Not Adequately Involved in State Government Accounting . . . . .	97
H <sub>6</sub> Autonomous Departments Restrict Efforts to Improve State Government Accounting . . . . .	98
Conclusion: H <sub>6</sub> Autonomous Departments Restrict Efforts to Improve State Government Accounting . . . . .	103
H <sub>7</sub> Accounting Improvements Are Not Implemented Because Legislators Do Not Follow-up to See if the Intent of Their Legislation Is Being Met. . . . .	103
Conclusion: H <sub>7</sub> Accounting Improvements Are Not Implemented Because Legislators Do Not Follow-up to See if the Intent of Their Legislation Is Being Met. . . . .	107
H <sub>8</sub> The Personnel Preparing Government Financial Reports Are Not Adequately Qualified . . . . .	107
Conclusion: H <sub>8</sub> The Personnel Preparing Government Financial Reports Are Not Adequately Qualified. . . . .	109
H <sub>9</sub> Accounting Does Not Measure Government Operations. . . . .	110
Conclusion: H <sub>9</sub> Accounting Does Not Measure Government Operations . . . . .	113
V. SUMMARY . . . . .	114
Disclosure. . . . .	115
Business Experience of Legislators. . . . .	116
Lack of Follow-up . . . . .	117
Accounting Principles . . . . .	118
Measurement . . . . .	118
Cost versus Benefit . . . . .	119
Source of Accounting Principles . . . . .	119
Autonomous Departments. . . . .	120
Involvement of Accountants. . . . .	120
Qualification of Personnel. . . . .	121
Conclusion. . . . .	121
BIBLIOGRAPHY. . . . .	123



APPENDIX A - Principles Presented by Oakey National Committee on Governmental Accounting Committee on Concepts of Accounting Applicable to the Public Sector General Accounting Office. . . . .	129
APPENDIX B - Legislative Cover Letter Legislative Questionnaire and Distribution of Responses Executive Cover Letter Executive Questionnaire and Distribution of Responses . . . . .	147

PREVIEW

## LIST OF TABLES

TABLE		PAGE
1	Defaults by Type of Local Government Unit . . . . .	25
2	Method to be Used for Recognizing Sources (Revenues) and Uses (Expenditures) of Resources . . . . .	29
3	Politicians Do Not Favor Disclosure. . . . .	77
4	Failure to Convince Management of the Need for Improved Accounting . . . . .	85
5	Impact of Selected Sources of State Accounting Principles. . . . .	88
6	Impact of Legislative Mandates on Efforts to Improve Accounting. . . . .	89
7	Legislators Lack Business Experience. . . . .	92
8	Accountants' Lack of Involvement. . . . .	96
9	Autonomous Departments. . . . .	99
10	Lack of Follow-up . . . . .	104
11	Lack of Qualified Personnel . . . . .	108
12	Accounting Does Not Measure Government Operations . . . . .	111

## CHAPTER I

### DEVELOPING ACCOUNTING PRINCIPLES FOR STATE GOVERNMENT

#### Introduction

Accounting principles for state government have been designed, but many have not been implemented. The objective of this dissertation is to identify and validate some of the reasons that state governments fail to implement accounting principles.

#### Accounting Principles

Accounting Principles Board Statement No. 4 identified generally accepted accounting principles when it was observed:

Generally accepted accounting principles incorporate the consensus at a particular time as to which economic resources and obligations should be recorded as assets and liabilities by financial accounting, which changes in assets and liabilities should be recorded, when these changes should be recorded, how the assets and liabilities and changes in them should be measured, what information should be disclosed and how it should be disclosed, and what financial statements should be prepared.<sup>1</sup>

Even though generally accepted accounting principles (GAAP) is a term that is widely used in accounting literature, no definition is universally accepted. For the purposes of this paper the wording from APB Statement No. 4 is acceptable since it illustrates the type of

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<sup>1</sup>"Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises," APB Statement No. 4 (New York: AICPA, 1970), Par. 137.

items included in that term. The term "principle" is used in this paper, although others are available, because of its acceptance in the government accounting literature.<sup>2</sup>

### Principles Development

#### Background

The accounting principles used by government entities differ from those used by commercial enterprises. Davidson et al.<sup>3</sup> attribute those differences to a publication of the Institute for Government Research prepared by Francis Oakey.<sup>4</sup> Since Davidson et al. believe that Oakey's principles form the basis for much of government accounting, they are included in Appendix A.

Oakey developed his principles for the controlling executive. The controlling executive establishes government policies from information provided to him by the chief accounting officer of the government.

Oakey also recognized two other types of users of government financial information. The first was the legislature.

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<sup>2</sup>National Council on Governmental Accounting, Exposure Draft GAAFR Restatement Principles (Chicago: Municipal Finance Officers Association, 1978), p. 1.

<sup>3</sup>Sidney Davidson, David O. Green, Walter Hellerstein, Albert Mandansky, and Roman L. Weil, Financial Reporting by State and Local Government Units (Chicago: The University of Chicago, 1977), pp. 16-25.

<sup>4</sup>Francis Oakey, Principles of Government Accounting and Reporting (New York: D. Appleton and Company, 1921).

Since the legislative branch of a government is vested with the power of raising revenues, providing for bond issues and authorizing expenditures, it must have complete information as to the cost of carrying on the activities of the government and the resources that are available, or that may be made available, for meeting such cost.<sup>5</sup>

Oakey seems to assume that the major emphasis of the legislature is on the receipt and expenditure of monies.

Although writing over 50 years before it became popular to consider the public as an important user of government financial statements, Oakey recognized that need. He contended that the public uses government financial information to evaluate "... economy or extravagance with which operations have been conducted by the executive branch."<sup>6</sup> Oakey suggested that the public should receive a financial statement as free from technicalities as possible.

His report explores in detail the needs of the internal user of government financial information. The public financial statement is not described. This focus on the internal government user is different from that held by most current accounting organizations. Their primary focus seems to be on the external user.

If we accept Davidson's argument that Oakey's principles provide much of the basis for current government accounting practice, then it follows that the foundation of present government accounting is predicated upon the failure to recognize the different classes of users

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<sup>5</sup>Ibid., p. 11.

<sup>6</sup>Ibid., p. 15.

suggested by Oakey.

### Present-Day Organizations

There are several organizations currently engaged in efforts to improve government accounting practices.

#### Financial Accounting Standards Board

The Financial Accounting Standards Board (FASB) is the organization responsible for setting commercial accounting standards. Government accounting, however, is affected in two areas by the FASB. First, the accounting standards for commercial enterprises are in some cases applicable to government. The second area of action involves the conceptual framework studies initiated by the FASB.<sup>7</sup> The remainder of this section on the FASB describes the significance of the FASB's standards and conceptual framework for government accounting.

Professional accounting has for several years attempted to develop the "grand design of accounting theory upon which all else would rest."<sup>8</sup>

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<sup>7</sup>Robert N. Anthony, Financial Accounting in Non-Business Organizations: An Exploratory Study of Conceptual Issues (Stamford, Connecticut: FASB, 1978). The conceptual framework study for commercial accounting, since it is expected to serve as the theoretical basis for commercial accounting standards of the FASB, may also affect government accounting. See also: Financial Accounting Standards Board, Conceptual Framework for Financial Accounting and Reporting: Elements of Financial Statements and Their Measurement: Discussion Memorandum (Stamford, Connecticut: FASB, 1976).

<sup>8</sup>American Institute of Certified Public Accountants, Report of the Study on Establishment of Accounting Principles (New York: AICPA, 1972), p. 15.

The efforts toward that end have taken several forms.

The standards or principles development started with the Accounting Research Bulletins (ARB). The ARBs were followed in 1959 by the Accounting Principles Board (APB) Opinions. The Accounting Research Bulletins and the APB Opinions were issued by professional accountants operating as a component of the AICPA. The releases were criticized on several grounds by the Wheat Commission report issued in 1972.<sup>9</sup>

First, the use of part-time volunteers to set the principles presented problems. The volunteers, since they were practicing CPAs, were not always independent from clients and could not devote the necessary time essential for developing a comprehensive foundation for accounting. Second, the use of CPAs to set accounting principles, the Wheat Commission suggested, precluded the consideration of a broader decision base and the use of a greater variety of skills in the development process.

The FASB was established to provide a full-time organization representing a broader base of financial interests than that found in the AICPA. The FASB Standards are a continuation of the process begun with the ARB and the APB Opinions.

The conceptual framework studies are a continuation of the search for a theoretical foundation initiated by the early research studies

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<sup>9</sup>AICPA, Establishment of Accounting Principles, pp. 15-16.

by Moonitz, and Sprouse and Moonitz.<sup>10</sup> The studies, then and now, were designed to develop a basis for accounting which could then be used to support the bulletins, opinions, or standards.

The activity described in the preceding discussion became formally applicable to government accounting in the AICPA Audit Guide for State and Local Governments. The audit guide provides that the APB Opinions, although developed for commercial enterprises, are also applicable to government organizations.<sup>11</sup> The standards of the FASB also are applicable.

The FASB and its predecessor organizations were primarily concerned with accounting for commercial enterprises when the Bulletins, Opinions, or Standards were released. This has changed. In 1977, the FASB engaged Professor Robert N. Anthony, the author of several texts on government financial management, to examine the conceptual issues of financial accounting for non-business organizations. That report was released in May of 1978.<sup>12</sup>

The Accounting Research Bulletins, APB Opinions, and FASB Standards are not included in the appendix due to their volume and widespread

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<sup>10</sup>Maurice Moonitz, The Basic Postulates of Accounting (New York: AICPA, 1961); Robert T. Sprouse and Maurice Moonitz, A Tentative Set of Broad Accounting Principles for Business Enterprises (New York: AICPA, 1962).

<sup>11</sup>American Institute of Certified Public Accountants' Committee on Governmental Accounting and Auditing, Audits of State and Local Governmental Units (New York: AICPA, 1974), pp. 140-57.

<sup>12</sup>Anthony, Nonbusiness Conceptual Issues.



availability.

National Committee on Accounting Principles of  
the Council of State Governments

The National Committee on Accounting Principles of the Council of State Governments is representative of several organizations that are involved with the needs of financial management officials of state government.<sup>13</sup> The activity of these organizations is oriented toward providing a forum for discussion and for analysis of various solutions to problems for the state officials. These officials can then apply the knowledge gained to the administration of their respective state governments.

The Council of State Governments has the widest representation of the organizations in this category. It provides a forum for governors, legislators, and other state officials to discuss state government needs.

The National Governors Association has a Committee on Executive Management and Fiscal Affairs that establishes policy for that organization regarding financial and managerial issues.

The legislative side of government is represented by the National Conference of State Legislatures. It explores concerns of a financial and managerial nature.

There are also organizations comprised of state officials which

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<sup>13</sup>Jonathan S. Gaciole, "Financial and Management Related Programs of State Government Professional and Public Interest Organizations," The Government Accountants Journal, 26 (Winter 1977-78): 58-60.

examine topics relating directly to a specific aspect of financial concern. Examples of this type of organization are the National Association of State Budget Officers and the National Association of State Information Systems.

#### National Committee on Governmental Accounting

The National Committee on Municipal Accounting was founded in 1934 by the Municipal Finance Officers Association.

The aims of the National Committee were:

- To set up principles and standards of municipal accounting;
- To develop standard classifications and uniform terminology for accounts and reports;
- To carry on an educational campaign to sell these principles and standards to governmental fiscal and accounting officers to the end that they would adopt them.<sup>14</sup>

The original committee consisted of the chairman of each of ten advisory committees set up by ten organizations to support the National Committee on Municipal Accounting. The name was changed in 1949 from the National Committee on Municipal Accounting to the National Committee on Governmental Accounting.<sup>15</sup> The advisory committees were designed so that the many organizations concerned with government accounting could provide input into the project. Among the organizations represented are the American Accounting Association, the American Institute of

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<sup>14</sup> Joseph M. Lowery, "The Role of Governmental Accounting in the 1970's," Municipal Finance, 42 (February 1970): 112.

<sup>15</sup> National Council on Governmental Accounting, Working Draft GAAFR Restatement: Introduction and Principles (Chicago: Municipal Finance Officers Association, 1977), Chapter 2, p. 53.

Certified Public Accountants, the International City Managers Association, and the National Municipal League.

The Committee has undertaken several projects that have resulted in statements of accounting principles for government. The first was released in 1934. It was the Tentative Outline--Principles of Municipal Accounting. This was followed in 1951 by Municipal Accounting and Auditing and in 1968 by Governmental Accounting, Auditing and Financial Reporting. Each time an update of the principles occurred (1934, 1951, and 1968), the advisory committee format was adopted. The number of advisory committees contributing to the revised principles was expanded each time to involve additional organizations in the development process (1934, 10 committees; 1951, 11 committees; and 1968, 15 committees).

On March 31, 1977, a working draft was released as the National Council on Governmental Accounting again updated the accounting principles for government.<sup>16</sup> Appendix A contains the 1968 principles and the proposed principles from the working draft.

Committee on Concepts of Accounting Applicable to the Public Sector 1970-71

This committee was formed effective August 1970, by the American Accounting Association. A report of its findings was released in the Accounting Review Supplement for 1972.<sup>17</sup>

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<sup>16</sup>Ibid., Chapter 2.

<sup>17</sup>American Accounting Association, "Report of the Committee on Concepts of Accounting Applicable to the Public Sector, 1970-71," The Accounting Review (Supplement to Vol. 47): 76-108.

The committee was charged with the task of examining the concepts of government accounting. The task was determined to be an identification and explanation of the existing concepts of government accounting rather than the formulation of new concepts.

A significant assumption was made as a starting point for the committee's work. "The committee accepted the basic standards set forth in A Statement of Basic Accounting Theory<sup>18</sup> as being authoritative for both the public and private sectors."<sup>19</sup>

Several unique aspects of the public sector were recognized by the committee. The first of these is the authority over the governed that public officials are granted. The authority was described as the following:

- 1) The authority to enact legislation by which the constituency must abide.
- 2) The authority to levy taxes to support the activities of government.
- 3) The authority to conduct monopoly enterprises in certain operations where charges are made to the users of certain services or products based upon the amount of service or product received. (e.g., public utilities).<sup>20</sup>

The committee also pointed out that public-sector organizations have a series of other characteristics that distinguish them from profit-

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<sup>18</sup>American Accounting Association, A Statement of Basic Accounting Theory (Chicago: American Accounting Association, 1966).

<sup>19</sup>American Accounting Association, "70-71 Public Sector Committee," p. 78.

<sup>20</sup>Ibid., p. 79.

making enterprises.

- 1) Contributors of resources receive no proportionate equity interest nor financial benefit from operations.
- 2) Performance of services is made on the basis of social need rather than the profit motive.
- 3) A framework of formal budgetary authorization and control is utilized.
- 4) Accountability to the public is essential because of public support through contributions and the privileges granted by society (e.g., tax-exempt status for non-profit organizations).<sup>21</sup>

The concepts the committee describes were designed to serve three types of financial statement users. The first two users are internal. They are the two divisions of government (legislative and executive) that share authority over financial and program development and review. The third type of user is the general public. The legislative and executive users receive their authority from and are accountable to the general public.

The concepts (see Appendix A for a detailing of the concepts) were oriented toward all three types of users. This differs from Oakey's concepts mentioned earlier that emphasized the needs of the internal (administrative) user.

A second major deviation from Oakey's report was the expansion of the entity concept.

It should be noted, however, that the concept of a fund entity is explicitly oriented toward fiscal control and

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<sup>21</sup> Ibid.

the safeguarding of expendable resources, not toward management information nor operational accountability.<sup>22</sup>

Government accounting is to provide more than fiscal control, according to the committee. It should provide information for management decisions and permit a review of the operations of government. The entity is to be reflected in the responsibility center. There would be four types of public-sector entities predicated upon levels of responsibility. The reporting for each type of entity (government, organizational unit, program, and fund)<sup>23</sup> should be designed so that the responsibility of officials at that level can be determined.

The interest of the American Accounting Association in public sector accounting has manifested itself in projects other than that mentioned above. Other committees have issued reports contributing to the development of public sector accounting. The 1957 Committee on Governmental Accounting issued a "Tentative Statement on Government Accounting."<sup>24</sup> Two reports have been issued by the Committee on Not-for-Profit Organizations. The first by the 1972-73 membership was issued in 1974, and discussed the issues and needs of not-for-profit accounting.<sup>25</sup> This report examined the research and educational needs

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<sup>22</sup>Ibid., p. 86.

<sup>23</sup>A definition of each type of entity is contained in the American Accounting Association section of Appendix A.

<sup>24</sup>Harold Wright, "Tentative Statement on Government Accounting," The Accounting Review, 33 (April 1958): 209-13.

<sup>25</sup>American Accounting Association, "Report of the Committee on Not-for-Profit Organizations, 1972-73," The Accounting Review (Supplement to Vol. 49): 227-49.

of that sector of accounting. In the report issued in 1975 by the 1973-74 membership, the Committee on Not-for-Profit Organizations reviewed several issues dealing with the users and uses of accounting data.<sup>26</sup> Finally, the Committee on Accounting in the Public Sector 1974-76 issued a report in 1977 examining aspects of auditing.<sup>27</sup>

Financial Management Standards Board--Government  
Accountants Association

The Federal Government Accountants Association (FGAA) was incorporated April 27, 1951. Four objectives were contained in the initial charter:

- to unite professional accountants for constructive endeavors;
- to encourage and provide a means for free interchange of ideas;
- to aid in the improvement of accounting and auditing; and
- to contribute to the improvement of education.<sup>28</sup>

The purpose of the organization was to provide a forum for federal accountants to improve national government accounting. Early membership was restricted to accountants who were employed by the federal government. The by-laws were amended in 1972 to include accounting, auditing, and other financial personnel from state and

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<sup>26</sup>American Accounting Association, "Report of the Committee on Nonprofit Organizations, 1973-74," The Accounting Review (Supplement to Vol. 49): 3-39.

<sup>27</sup>American Accounting Association, "Report of the Committee on Accounting in the Public Sector," The Accounting Review (Supplement to Vol. 52): 33-52.

<sup>28</sup>The History Task Force, "The First Twenty-Five Years," The Federal Accountant, 24 (June 1975): 30.

local governments.<sup>29</sup>

The Federal Financial Management Standards Board has undertaken several projects relating to government accounting.<sup>30</sup> The projects listed below are examples of the organization's activity directed toward improving government accounting:

1. A code of ethics for federal financial personnel;
2. Accounting research in cooperation with the AICPA; and
3. Research relative to regulations proposed by the Cost Accounting Standards Board.

The FGAA is represented on the Board of the Financial Accounting Foundation and the FASB Advisory Council.

The History Task Force of the FGAA stated that in 1974 the FGAA was instrumental in the formation of a consortium to explore areas of mutual interest to the several organizations involved in government accounting.<sup>31</sup>

In attendance were representatives of AICPA; American Society of Military Comptrollers; Council of State Governments; Municipal Finance Officers Association; National Association of State Auditors; Controllers and Treasurers; National Association of State Budget Officers; and the Post Audit Section of the National Legislative Conference.<sup>32</sup>

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<sup>29</sup>Ibid., p. 32.

<sup>30</sup>Ibid., p. 39.

<sup>31</sup>Ibid., p. 42.

<sup>32</sup>Ibid.