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# How Accountants Can Serve Municipalities\*

BY CARL H. CHATTERS

Municipalities need help in solving their financial problems. They want improved budgeting and accounting. They need trained personnel. Their debts are heavy and their revenues uncertain. Loose talk about excessive governmental expenditures goes unchallenged because cost standards are not used. Conditions are improving. Surely the professional accountants, with their knowledge of financial problems, can bring about permanent improvements in public affairs. They must qualify themselves to serve in this specialized field; they must develop standards, study revenues and expenditures and professionalize the public service. They can serve directly in many ways.

## QUALIFYING TO SERVE MUNICIPALITIES

To be of service to municipalities, accountants must first qualify themselves to serve. As a preliminary training they need a thorough knowledge of both general accounting and auditing practice. However, the practice of municipal accounting needs special experience. In order to serve effectively, accountants must acquire an understanding of the economic, social and political questions involved in the financial and accounting problems of government.

I do not imply that an accounting firm must confine itself to this class of work entirely. I do mean, however, than an organization which makes a pretense of being able to conduct a municipal audit without previous experience in municipal affairs is being unfair to its client and to itself. I have no use for the unqualified auditors who are willing to undertake a municipal engagement. One of the outstanding members of the Institute wrote me a short time ago as follows: "I am not absolutely convinced that we need to develop specialists for governmental work to the extent of individuals and firms restricting their practice to work of this type, but I am convinced that it is little short of fraudulent for any firm to undertake an engagement for a unit of government unless it has partners or staff members

\*An address delivered at the annual meeting of the American Institute of Accountants, Chicago, Illinois, October 16, 1934.

available who have academic and practical training for such an engagement." This expresses my own opinion, and I feel sure that, if such an aim became a reality, both the accounting profession and municipalities would profit.

Accountants, to be of service to municipalities, must recognize the difference between accounting for public and private enterprises. Until they do they are in no position to serve municipalities. They must recognize the different objectives of the two types of organizations. A public corporation exists solely to be of service and not to operate for the profit of a limited group. Municipal property does not serve as a basis of credit in the manner common to the private corporation. Furthermore, the activities of public bodies are hedged about by certain legal and constitutional limitations. A knowledge of these factors is necessary to an understanding of public affairs.

My next suggestion may seem beside the point and not applicable to this story. I believe, however, that auditors interested in municipal affairs must look at the human aspect of public problems. Politics and government are necessarily concerned with human relationship. They deal with persons, not things. Incidentally, one of the reasons why business men usually fail in politics is because they lack sympathy for the vast multitudes of people and fail to grasp the intimate human nature of public service. Furthermore, accountants themselves must take on a more human personality and not become as impersonal as adding machines.

Even accountants' mental approach to the municipal problem must be changed. They must not act on the assumption that every public officer is a rascal or an incompetent and that most of his acts are committed in bad faith. It is only fair to the man in public office to assume that he is intelligent, competent and honest until an audit of his record proves otherwise. If accountants will take this attitude their relations with their municipal clients will be improved.

#### STANDARDS NEEDED

Definite principles and standards of practice in the municipal accounting field have been sadly lacking. Accountants who wish to be of the greatest assistance to public bodies must assist in their development. Officers often hesitate to take one accountant's recommendations because another accountant may come

along later and make recommendations exactly opposite to the former's.

Accountants must agree upon the fundamental principles of municipal accounting and the terminology to be employed. The American Institute of Accountants is already contributing to this end by its active participation in the work of the National Committee on Municipal Accounting. Professor Lloyd Morey, who is chairman of your committee on governmental accounting, is vice chairman of the national committee. This group is making the first major effort to establish fundamental principles of municipal accounting. The central committee is composed of nine members, one representing each of the following associations:

American Association of University Instructors in Accounting

American Institute of Accountants

American Municipal Association

American Society of Certified Public Accountants

International City Managers' Association

Municipal Finance Officers' Association

National Association of Cost Accountants

National Association of State Auditors, Comptrollers and Treasurers

National Municipal League

The bureau of the census is also interested in a liaison capacity. Each organization represented has also a subcommittee on municipal or governmental accounting. Thus the entire group now consists of fifty-four persons. Since its organization in January of this year the committee has published *A Tentative Outline of the Principles of Municipal Accounting*, *A Bibliography of Municipal Accounting*, and *A Suggested Procedure for a Detailed Municipal Audit*. There is now in the hands of the committee for criticism a classification of municipal funds, assets and liabilities. Terminology is being developed by Professor Morey and Walter Mucklow with the aid of a special committee. The difficult task of formulating revenue and expenditure classifications is also under way. Forms of schedules for municipal financial reports will be prepared. The Institute's continued cooperation with the committee will be a distinct service to both accountants and municipalities.

The cooperation of accountants and public officers has taken a practical turn in Florida, also. The Florida League of Muni-

palties and the Florida Institute of Accountants are both interested in the development of uniform accounting and reporting. The two groups formerly worked independently and frequently at cross purposes. They were brought together through contacts with the National Committee on Municipal Accounting. The chairman of the municipal league's committee attended the excellent meeting of the Florida Institute of Accountants held in June, 1934. Working relations between the groups have been established and a joint committee of the league, the Institute, and the state auditing department has been formed. Surely this will bring more effective results than independent action. Public officers are like other human beings—they are more willing to use those things which they help develop than standards which they feel are imposed by outsiders.

#### AUDITING

Accountants may aid municipalities by developing better systems of audit. The ordinary investigation must be made more thoroughly. The resulting audit report, together with the letter of transmittal and audit certificate, should be unequivocal so that both the citizens and the public officers may know what has taken place. There should be audits of operating results based on cost accounting when it has been developed. There should be internal audits designed to reduce the cost of external audits. There should be examinations of the accounting systems of the municipality to determine whether or not they are adequate to provide all necessary information. Certainly the auditing field is the most common one in which accountants are engaged, and therefore their first efforts should be devoted to developing better audit procedures. However, I do not want to imply that officers should look upon accountants merely as auditors. As long as they do so the accountant's value to them will be limited.

Accountants interested in municipal audits will want *The Suggested Procedure for a Detailed Municipal Audit*, published by the National Committee on Municipal Accounting. This follows the same lines as the excellent publication, *Verification of Financial Statements*. The committee has recommended that in engaging auditing services, primary consideration be given to the qualifications of the auditors to perform a municipal audit and that preference be given to certified public accountants.

Perhaps the vicious custom of awarding municipal audit contracts to the lowest bidder, regardless of his qualifications, may be responsible for many unsatisfactory engagements—unsatisfactory to the accountant and to the municipality. The National Committee on Municipal Accounting disapproves the awarding of audit contracts on a competitive basis. The remedy for the bidding evil depends upon the further education of public officers to the requirements of an audit and upon the elimination of those accountants who take an engagement at a low price regardless of their own qualifications of the nature and extent of the work. Public officers must know what to expect from an audit and then retain auditors with professional pride, knowledge and experience.

The report must state clearly the facts disclosed by the audit. It should not flatter in order to obtain succeeding engagements, nor should it condemn for purely political purposes. Auditors should always maintain their independent professional position.

It might be well to consider having an oral audit report made to the governing body. Perhaps the outside auditor and the chief financial officer of the municipality might appear before the proper committee after due notice to citizens at large that such a hearing would be held. At this hearing both the citizens and the committee might question both the auditor and the chief financial officer. This would serve to restore public confidence by giving the impression that all the financial transactions of the public body were being made known without reservations. When citizens are properly informed of governmental activities they will vote more intelligently and will listen to fewer political stories which are circulated solely to get votes.

#### BOOKKEEPING NOT AUDITING

Public accountants should not attempt to carry out the duties of regularly appointed or elected public officers. To do so will only perpetuate incompetency in office and prevent the development and education of the men and women holding these positions. Accountants from the outside should not do the bookkeeping for a municipality and allege that they are thus conducting an audit. If they did they would be in the same class as the bookkeeping machine salesman who said that if he bought the machine, its work would constitute the audit and there would be no need for an outside auditor. Independent auditors should

insist that public officers prepare their own reports and balance their own records. If the accountants are sincerely interested in the improvement of municipal affairs, they must assist in the proper training of public officers by refraining from doing their work for them. Accountants have a big opportunity in public affairs, but they should not usurp the authority of the regular officers.

#### PERSONNEL

The type of person appointed to public office should concern the auditor. Physicians insist on professional men for health officers, and engineers demand engineers for engineering jobs. It therefore seems logical for the professional accounting societies to promote the appointment of properly qualified persons to municipal accounting and financial positions. No matter what standards of accounting exist, the work carried on can never rise above the intelligence and initiative of the officers who are appointed or elected to use them. There are particular difficulties in the smaller communities where it is scarcely possible to retain anyone with either professional standards or adequate training. This means, then, that accountants must devote themselves to promoting forms of government which will permit the employment of trained personnel. A foreign journal recently carried a statement by a high government officer that a municipality which could not afford to hire an engineer properly qualified to supervise its activities had no business to exist. Our American municipalities should give this thought some consideration.

Many well trained men, including certified public accountants, are already in public service. These men, who are elective or appointive state or local officers, are well qualified according to the accountants' own standards. They are frequently numbered among the key persons in their respective departments and are not affected by political upheavals. Certified public accountants hold the position of state auditor in Maryland and Texas and important positions in the cities of New York, Kansas City, Grand Rapids, Seattle and St. Paul.

The public service will not attract the kind of person needed in a technical position unless suitable compensation is provided. Accountants must assist in forming public opinion to this end. Each accountant must also see that his own community pays

salaries commensurate with the requirements of each accounting position. Within the last month the city auditor of a city of 125,000 population, a certified public accountant, resigned because his salary was only \$3,240 a year. Professional societies must carry the responsibility of filling public position with professional men.

#### REVENUES AND EXPENSES

Most of the discussions about municipal government concern either the cost of government or the raising of revenue. Until unit cost accounting can be developed, there will be little possibility of discussing governmental affairs on the basis of merit. Therefore, a vital factor in the improvement of local government is the development of proper cost-accounting methods. They are necessary for planning the budget and for comparing costs. It is now impossible to know whether or not activities of a particular government unit are performed at the lowest possible cost from period to period or with equal efficiency in different organization units of the same municipality. It is impossible to know whether a certain activity is carried on as economically in one municipality as in another. When it is possible to determine these facts, many misleading statements can be taken out of the discussion of municipal activities. If I were to make no other point I would like to stress this, namely, the necessity for the development of unit cost accounting for municipalities.

The question of revenue is the most pressing problem before local governments at the present time. Therefore, accountants who wish to act as financial advisers must study thoroughly the sources of municipal revenue. They must know the statutes of the states in which they operate and the limitations placed on the public bodies for the raising of revenue. They must also know what is being done in other states and other localities within the same state to obtain public revenues. They must have a thorough knowledge of economics and some idea as to how the cost of government should be distributed in accordance with available wealth and income. Of course, when one discusses tax matters he gets into the field of theory, and decisions on revenues will incline toward various social and economic philosophies. Some will contend that the revenues should come from an income tax; some, influenced from other sources, may contend that the sales tax is the only method of financing government. Out of all the



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proposed methods accountants surely should be the group able to make some proper deductions as to who should pay the cost of government. Looking at the matter more narrowly, properly trained accountants can advise the municipality with regard to certain tax policy matters.

### STATE, COUNTY, LOCAL RELATIONSHIPS

The financial relationship between county and municipal governments creates a serious situation. It is necessary for auditors and accountants to look carefully into these relationships in any engagement. In most states the counties either collect all taxes or collect delinquent taxes after the city has collected the current levies. An investigation of the records of the three thousand and more counties in the United States would disclose the fact that practically none of them sets up on its books as an asset the taxes placed in its hands for collection by the other local governments. Neither do counties set up on their records any liability to the other units. Therefore, it is frequently impossible for either party to know whether or not the money due and collected has been turned over. Any one who has made investigations of county offices will bear out this statement. Therefore, both for the sake of the profession and for the benefit of municipalities I urge accountants to insist that counties make proper accounting of money collected by them on behalf of other local governments.

Many state agencies are charged with the development, supervision and auditing of municipal accounts. As professional people accountants want to see that the accounting systems are developed and kept up to date and are not permitted to become mediocre or worse. Certainly they do not want standardization to mean merely standardized stupidity. They have a right to insist that the agencies charged with the supervision of local accounts maintain proper personnel with professional standards. In many cases, state departments and practising accountants may coöperate to mutual advantage. Unless men of training, vision, and ability work for the state, the accounting of all the local units in a state will be reduced to a low level. It may be to the interest of accountants to see that such state bodies carry out their duties aggressively. Accountants want no state agency to take from their hands work in which they are interested.

Let me say, on behalf of the state officers who conduct municipal audits, that they carry out well one phase of their work which

probably is minimized by some accountants. State bodies emphasize the legal aspects of the audit of receipts and disbursements. Perhaps sometimes they carry this point too far. However, if the professional accountants are going to compete with state agencies, they must know sufficient municipal law to be able to tell whether or not disbursements have been made legally. There will be much objection to this point, but if a disbursement is not legal, surely it is the auditors' duty to call it to the attention of the public body.

#### WAYS TO SERVE DIRECTLY

In the March, 1934, issue of *THE JOURNAL OF ACCOUNTANCY*, your official magazine, there appeared an article by G. Charles Hurdman, entitled "Unrecognized opportunities for public accountants in the municipal field." The first time I read this I was in serious disagreement with Mr. Hurdman and wrote him to that effect. In the preparation of this paper, I have read and reread this article. I now concede that Mr. Hurdman is substantially right, provided the accountants can prepare themselves for the services which he enumerates. Many of the matters which I discuss now were suggested by his paper. In general, he said that accountants could help with the development of budgets, both capital and current, the solution of debt problems, the assessment of property and public reporting.

First let me discuss one point on which I take issue with Mr. Hurdman. He says the public accountant, with his training in actuarial and financing matters generally, can do much to stabilize municipal credit by advocating the use of sinking funds for the retirement of bonds. This statement is contrary to general opinion of municipal finance experts and bond men who are now trying to prevent the issuance of sinking-fund bonds and to substitute serial bonds.

Hundreds of municipalities of various types are having difficulties with their debts. Many wish to avail themselves of the so-called "federal municipal bankruptcy act." Accountants have taken an interest in this and some have written to me to know how to make the necessary contacts to obtain engagements. Bond refunding is limited to accountants who have a broad knowledge of the bond market, economics, law and public affairs. The chief question at issue in the debt adjustments is the ability of a municipality to pay its debt at the present time

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and at indeterminate dates in the future under indeterminate conditions. Most of the work of this kind, including the refunding of outstanding bonds, is being carried on, not by accountants, but by former municipal bond men. Such a job would probably be best accomplished by accountants, provided they had all the other qualifications which are necessary to carry on debt adjustments. However, I do not know of one case yet where outside accountants have been employed to handle such matters. This field presents opportunities at the present time.

Many accountants are specialists in departmental organization. Here they can be of material assistance to the municipality. They can suggest a type of organization for the entire financial function that will assure proper accounting procedure and control. They can also help to organize the work within the finance department and within the various bureaus or divisions of the department, so that it can be conducted in the most economical way and at the same time provide the basis for internal audits. If accountants are in general agreement that there should be a greater proportion of appointive officers, they may also work to this end, so that there may be no conflict, for example, between the elected treasurer and the appointed accounting or financial officer. They can also advocate the centralization of all authority for accounting and financial procedure.

We are now beginning to recognize the value of sound assessment of property for taxation. Certainly the assessment of personal property is a field for accountants. The factors entering into these assessments are largely accounting matters and therefore well within their realm. I doubt, however, if accountants are qualified to assess real property. It seems to me that this is the job of the engineer. If an audit of a municipality were thoroughly conducted, however, the auditors might be required to make a test check of the valuation placed upon certain properties. This certainly would be well within the scope of any investigation intended to disclose whether or not all of the public officers were conducting their activities without fear or favor. I believe that while the accountant may help to develop standards of assessing, the real job of assessing municipal property should be done by trained and impartial public officers. I do not want to minimize the necessity of good assessing. It is the foundation of the revenue system of our local governments, while they are financed principally from real-estate tax levies.

The field of public reporting offers an unusual opportunity for public accountants to show their originality and ability. Even the letter of transmittal with the formal report should be intelligible both to the officers of the public body and to the citizens at large. It should be clear and unequivocal. An accountant, in a recent letter to me, said, "Frankly, I question the possibility of preparing an accountant's audit report of a municipality that shall be understandable to the layman unless the layman has a reasonable foundation in the elements of government and of accounting." If this is true, I can see little value in having audits or reports made. Another accountant, however, has demonstrated the possibilities of public reporting by preparing for the newspaper in the city where he conducted an audit, a clear report of his findings written for popular consumption. In any case, how much good can an audit report be if it can be understood only by one or two persons in the municipal employment, and not by the balance of the officers or the public at large?

Accountants can be of service in matters related to the budget and to financial planning. For the current budget, however, the activities of the outside accountants should be directed more to the form of the budget than to the content and to the individual matters in it. They can convince the city council that the budget ought to be prepared on a basis which is reasonable and is adequately financed. They can suggest the form that the budget should take. They should not take part in the discussion of the detailed matters within the budget nor make decisions with respect to appropriations for various activities or departments. However, when they are engaged to make a special investigation, which would qualify them to advise on such matters, it would be proper to do so.

Accountants who are properly trained and have had a broad municipal experience could be called in to assist a municipality in preparing financial plans, financial program and financial policies. Financial planning would provide the best field for the broadly trained, experienced, municipal accountant. It certainly requires unusual knowledge and vision. Financial programs ought to be prepared for capital outlays for a long period of years. A financial program for the current year should be set up properly to make sure that no deficit will ensue. Many financial policies are also involved in the decision of the public bodies. There is a vast difference between one who is employed

merely to make an audit of municipal records and the accountant with broad training and knowledge who is in a position to act as adviser. The former is limited in his usefulness; the latter can serve in a broad and constructive manner.

#### CONCLUSION

Both private accountants and public officers have been looking at accounting and reporting too narrowly. Many of them think they have done their duty when their books are balanced. That step is essential, but it is only the beginning. The important thing is to prepare reports which will give information necessary for operating purposes. Too much emphasis has been placed on the mere form of accounting and bookkeeping. Mere figures must be translated into human action and into reports which are the basis of operating information for the administrative officers. Bookkeeping, accounting and auditing in themselves are of little use. They take on value only when they become the basis of action. When accountants have trained themselves so that they can take the figures from the records maintained by bookkeepers, translate these into helpful reports for the use of operating officers and administrative authority, and when they have been able to interpret these reports properly for the public, then accountants will be better able to serve cities. Municipalities need help. They are expecting guidance from accountants.