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**Conference on Municipal Accounting and Finance of the
American Institute of Accountants, Chicago: March 28 and 29,
1938: Addresses Presented at the Conference**

American Institute of Accountants

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on
Municipal Accounting
and
Finance
of the
American Institute
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Accountants

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Chicago
March 28 and 29
1938
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ADDRESSES PRESENTED
at
THE CONFERENCE

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(Proceedings)

Published by
American Institute of Accountants
135 Cedar Street
New York

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Price — One Dollar

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A c k n o w l e d g m e n t

Cooperation of ten state and national groups in the planning for the conference on Municipal Accounting and Finance was responsible in large measure for the success of the Conference. These groups, to whose officers special thanks are extended for their active interest and cooperation, are the following:

Municipal Finance Officers Association
National Committee on Municipal Accounting
Tax Policy League National Municipal League
National Association of Cost Accountants
Investment Bankers Association of America
Committee for Better Audits, Surety Association of America
Illinois Bar Association Illinois Chamber of Commerce
Illinois Society of Certified Public Accountants

Special Committee on Governmental Accounting
AMERICAN INSTITUTE OF ACCOUNTANTS

P R O G R A M

CONFERENCE ON MUNICIPAL ACCOUNTING AND FINANCE
of the
AMERICAN INSTITUTE OF ACCOUNTANTS
Stevens Hotel Chicago
March 28 and 29, 1938

Monday, March 28

10:00 A. M. -- Opening Session

Presiding: FRANK J. FLANAGAN, Chairman, National Committee on Municipal Accounting;
Finance Committee Staff, City of Chicago.

Keynote Address--

GEORGE P. ELLIS, C.P.A., Wolf and Company, Chicago--General Chairman of the Conference and Chairman, Committee on Governmental Accounting, American Institute of Accountants.

Address: Work of the National Committee on Municipal Accounting--

CARL H. CHATTERS, Chicago--Executive Director of the Municipal Finance Officers Association of the United States and Canada.

2:00 P. M. -- Technical Session

Discussion Subject: Aspects of Accounting as Related to Internal Management

Presiding: FAYETTE H. ELWELL, C.P.A., Madison, Wisconsin--Member, Executive Committee, National Committee on Municipal Accounting.

Legal Obstacles--

Speaker: DENEEN A. WATSON, Illinois Bar Association.

The Surety Company's Interest in Municipal Audits--

Speaker: ROBERT STEINEMANN, New York--Chairman, Committee for Better Audits, Surety Association of America.

Possibilities in Municipal Cost Accounting--

Speaker: ALBERT E. NEALE, Chairman, Municipal Accounting Committee, National Association of Cost Accountants; City Auditor of Springfield, Massachusetts.

In Making and Controlling the Budget--

Speaker: C. C. LUDWIG, C.P.A., Executive Secretary, League of Minnesota Municipalities.

7:00 P. M. -- Conference Dinner

Presiding: GEORGE P. ELLIS, C.P.A., General Chairman of the Conference.

Toastmaster: HERBERT F. EMMERICH, Chicago--Assistant Director, Public Administration Clearing House.

Address: Accounting Controls in the Federal Government--

E. F. BARTELT, Commissioner of Accounts and Deposits, Treasury Department, Washington.

Tuesday, March 29

8:30 A. M. -- (A) Breakfast Round Table

Discussion Subject: Municipal Accounting Installations

Presiding: HARVEY C. DAINES, C.P.A., Assistant Comptroller, University of Chicago.

1. Making Survey to Determine Needs--

Speaker: DONALD C. STONE, Public Administration Service, Chicago.

2. The Technique of Municipal Accounting Installations--

Speaker: T. COLEMAN ANDREWS, C.P.A., Richmond, Virginia--Member, Committee on Governmental Accounting, American Institute of Accountants and formerly Auditor of Public Accounts, State of Virginia.

8:30 A. M. -- (B) Breakfast Round Table

Discussion Subject: Theory and Practice in Municipal Accounting

Presiding: J. H. GILBY, C.P.A., Chicago.

1. The Basic Principles in Municipal Accounting--

(Its similarity to and differences from industrial and commercial work.)

Speaker: LLOYD MOREY, C.P.A., Vice-Chairman, National Committee on Municipal Accounting; Comptroller and Professor of Accounting, University of Illinois.

2. The Practical Application of Municipal Accounting Principles--

Speaker: GEORGE D. BAILEY, C.P.A., Resident Partner, Ernst and Ernst, Detroit.

11:00 A. M. -- General Session

Presiding: GEORGE P. ELLIS, C.P.A.

Address: Financial Planning for the Municipality--

H. L. WOOLHISER, City Manager, Winnetka, Illinois.

12:30 P. M. -- Conference Luncheon

Presiding: EDWARD B. WILCOX, C.P.A., Edward Gore and Company; Vice-President, Illinois Society of Certified Public Accountants.

Introduction of the Speaker -- CARL H. CHATTERS, Municipal Finance Officers Association.

Address: A Program of Municipal Revenues and Expenditures to Meet Changing Social, Economic and Political Conditions--

HON. JAMES W. MARTIN, Commissioner of Revenue, State of Kentucky.

2:00 P. M. -- Non-Technical Session

Discussion Subject: Accounting as Related to Agencies Outside Government

Presiding: STUART M. CAMPBELL, C.P.A., Arthur Andersen and Company.

1. Accounting Reports and Municipal Credit--

Speaker: JOHN S. LINEN, Chairman, Municipal Securities Committee, Investment Bankers Association; Second Vice-President, Chase National Bank, New York.

2. Personnel in Municipal Accounting Offices--

Speaker: PROFESSOR A. R. HATTON, Northwestern University.

3. The Public's Interest in Municipal Reports--

Speaker: DOUGLAS SUTHERLAND, Secretary, Civic Federation and Bureau of Public Efficiency, Chicago.

KEYNOTE ADDRESS

George P. Ellis, C.P.A.
Chairman, Special Committee on Governmental Accounting
American Institute of Accountants

Better municipal accounting is both a professional and a social obligation. As accountants, we need to do a uniformly better job of leadership and cooperation with the public and with municipal finance officers to improve the making and the use of the public records. In so doing, we must be educators as well as technicians to bring home to all interests, their community of interest in sound local government. Sound accounting is basic, but it cannot of itself raise the general level of public records and financial control, -- it must be used in the way designed. In other words, only when the pattern is right, can the test of use show results. Sound accounting should produce effective control of expenditure.

The case for sound government in the state and the national sphere rests squarely upon better knowledge and integrity in local government. It is not only the physical difficulty of financing the ever-growing budget of public functions, but the social implications as well, that make sound municipal accounting so vital a consideration. At the turn of the century, cities of 30,000 and over were spending an aggregate of half a billion dollars; a quarter of a century later, the aggregate was more than four times as much, or something over two billions. And much of this expenditure "like Topsy" just "grewed". The per capita expenditures for operation and maintenance of cities of over 30-thousand population increased 30% to 40% in the 15-year period from 1915 to 1929. According to the report of the National Industrial Conference Board for 1936, government costs reached the staggering figure of 17-billion dollars. The gross debt of all divisions of government increased 37% between the years 1932 and 1936, reaching the monstrous total of over 53-billion dollars. Taxes absorbed more than one-sixth of the realized national income for the year 1935. There was a rise of nearly 50% in governmental expenditures per capita in the period from 1923 to 1935.

These figures have increased since 1935 and seem likely to increase still further. The result is a growing public consciousness of the tax burden, without a corresponding comprehension of the cause and how to deal with it. When the pressure becomes too great, the lid blows off as it did in Cook County over the property tax assessment. The tax rebellion dislocated local government over a period of years, but it accomplished little basic improvement. There are still 700 odd tax units in Cook County, and the average voter is still uninformed as to what becomes of his tax money. In short, the average citizen continues to worry about his tax bill with little thought as to the accounting and control of what is to become of the money he rebelliously pays on these tax bills.

In a manner of speaking, business has let itself be taken for a "ride" by political bodies which poke into every phase of business operation. Governmental bodies demand of business the most detailed record of every operation regardless of whether the governmental regulation is good accounting or bad. But business which, as an intelligent electorate, after all has the whip-hand if it cares to exert itself, has been completely indifferent to forcing upon governmental bodies the same kind of careful and accurate recording and reporting. It is time that business interests everywhere in their own and in the common interest take the initiative in demanding that the financial operations of public

business -- everybody's business -- be accounted for as accurately and as efficiently as governmental bodies have required of private business. In short, there is need both for the slow educational contribution of an expert and professional group like this and there is need for the awakening of the electorate to an understanding of the financial problems of responsible democratic government.

Without such popular comprehension based upon exact accounting information, it is a trying business on the part even of the ablest officials, to keep any sort of balance between the popular pressure for more and more services to the public, and the cost of financing such service.

In the demand for more services, taxpayers lose sight of what are proper governmental functions. The tendency is to regard everything done by a local government as a "governmental function". A certain typical city which had 21 functions when it was incorporated now has 356 -- all arbitrarily considered by the layman as "governmental" functions. Whereas, only 58 or 16% of the 356 are truly governmental. Probably the average is not more than 25%.

Lately this problem of what is a governmental and what is a proprietary function has been approached from a new angle because of the exemption of governmental bodies from State and Federal Social Security taxes. Most of the states have held that so typical a municipal proprietary function as a city-owned utility is an instrumentality of government and, therefore, exempt. But the state of Ohio in ruling upon the type of exemption has attempted to put the theoretical distinction into practical effect. Ohio Unemployment Compensation Commission has ruled that:

Purely governmental functions shall mean the performance of duties . . . by virtue of a constitutional provision or legislative enactment for the protection of society from crime and vice, for the preservation of peace and health, the education of citizens, and the protection of their property.

Where there is no obligation to perform certain functions but (the local government) does in fact do so for the comfort and convenience of its citizens, and where it may elect whether to do or omit to do these acts, the function is private and proprietary.

On this basis, Ohio does not exempt from Unemployment Compensation taxes -- municipally owned electrical and gas generating plants, waterworks, auditoriums, stadia, markets and parks.

Yet, in the application of the Social Security tax laws, such a neatly drawn distinction is purely academic and without practical significance. Necessary as it is that the voter should understand the difference between what his government does for him because it is government, and what his government does for him because he wants to be relieved of the job of doing it himself, -- this attempt in Ohio to make a physical separation of function, as I see it, only piles up confusion and adds to the opportunity for political mismanagement. I think the Ohio Commission has not thought through its practical problem of administration.

The point where the issue must be drawn is the voter's election to pay the high cost of assuming non-governmental undertakings. We have the task of showing him that cost in such understandable form that he will know what he is doing. It is evident, for example, that the taxpayers' demand for exemption of taxes on homesteads has lost sight of the fact that these same home-owners are insisting upon increased school facilities, greatly expanded curricula, extended recreational equipment and programs, better streets, better lights, better police -- better and more of everything, except taxes.

Studies carried out in typical cities show that there has been a greater increase in added functions to city governments in the past 20 years, than had been added in the previous 75 or 80 years. The increase in recreational activities is particularly striking. These range anywhere from folk dances, pageants and plays, to football, basketball and general playground supervision. Such findings indicate a considerable trend toward collective-ism. Perhaps, inevitably, an individualistic social order, as it progresses to a more civilized condition, shows a trend toward collective-ism through the assumption by government of more and more of the groups' activities. Many activities should, of course, be handled by the government. Such activities as education, sanitation, health, sewage disposal, etc., are clearly governmental functions. However, a great many other functions need to be dealt with candidly and subjected to a careful analysis to determine whether or not they are in the interest of genuine social progress. For, too much of the burden upon local governments seems to have been placed there, not by conscious choice but by the inertia and uninterested ignorance of the electorate, who have been contented to drift along letting pressure groups and persons make the vital decision for them.

Cost Accounting

Once the decision is made -- whether rightly or wrongly, it is certain the governmental unit which has undertaken proprietary functions should function at least as cheaply as any other agency could do them. That calls for cost accounting -- not to determine profit, but to determine true cost. Governmental bodies are meant, as a rule, to provide service at cost. This means cost in relation to quality as well as quantity, -- cost in terms of the value of the service performed.

To a large extent this is quite intangible -- a psychological appraisal. Mr. Charles A. Ridley in an article on the technique of appraising standards, says - "A generation ago a municipal government was considered commendable if it was honest. Today we demand a great deal more of our public service. It must be not only honest, but efficient as well." It is, therefore, necessary to develop standards of measurement and by proper accounting to arrive at a basis for comparing the relative efficiency of city governments. It is impossible to make an intelligent comparison of tax rates unless both the amount and the cost of the service for the tax rate is weighed. Two cities of the same size and general characteristics, with the same tax levy, may not be at all comparable on the basis of cost of municipal service. This subject will be discussed during the conference by a public official who has proved its importance by experience. Where cost accounting has been introduced, it has resulted in considerable savings to the municipality.

Budget Control

Furthermore, until cost finding is developed where it is necessary, the

budget of expenditures, and to some extent, the budget of revenues cannot help being more or less guess-work. Full and complete records of revenues and expenditures are essential to any degree of proper budget making and budget control. In the handling of this problem the accountant has the responsibility for professional knowledge and integrity, and the public official for detail efficiency and for a degree of social insight verging on statesmanship.

Municipal accounting theory and practice have made vast strides in the last 20 years. Twenty years ago such an instrument of planning and control as a municipal budget was virtually if not entirely unknown; today, every city worthy of the name has some program of planned expenditure, although budget control is by no means perfected. And the layman still does not know the difference between governmental budgeting and business budgeting. I am glad that this subject of theory and practice is to be one of our major topics for discussion, and that the financial planning behind the budget is to be discussed in General Session.

In the last five years especially, there has been far greater improvement in accounting than ever before. Over two-thirds of the large cities now have quite complete mechanical installations. County offices also are better equipped and operated.

As a result of the growing importance of better accounting to cope with this great problem, the National Committee on Municipal Accounting was organized in 1933 to establish a basic program toward which the various state requirements can be shaped. An outline of the work of this Committee will be presented during the conference.

Perfect uniformity will not be attainable so long as state laws governing local governments vary so much. A representative of the Illinois Bar Association will discuss some of these legal obstacles during the conference.

Municipal Reports

The accounting officer has a real social responsibility, both to care well for public funds and to educate the citizenry as to the way in which the money raised by taxes is used. Business groups are gradually learning to take their public into their confidence by financial statements so explained that any novice can comprehend them. If politics could be discussed upon the basis of unequivocal facts drawn from the accounting records, instead of having recourse to hearsay, we would be on the way to better local government. One reason for the taxpayer's lack of understanding of the basis of high taxes, is that financial reports have not been prepared for popular consumption. Some improvement is taking place, but the process of education has scarcely begun, and is made more difficult by the differences between governmental and business accounting practice. That is a subject that will be discussed in the course of this conference, and it should be far more than a routine technical discussion. The quality of municipal reports has displayed a remarkable improvement in recent years. This refers to the report prepared for the public in popular form as well as to the formal financial report.

Often, too, legislative bodies and public officials flounder about in dealing with difficult fiscal problems because of inaccurate and inadequate information. The chief executive of a city should be able to obtain at least every

month, for his own guidance, a brief "one page" report of revenues and expenditures, as well as the quarter and annual full statements to the public.

To me, the hope of our popular government rests upon brief, comprehensive, well-coordinated, simply phrased reports, which any intelligent person can comprehend. When our electorate understands they will exhibit the interest we want them to exhibit in behalf of sound procedure.

The importance of reports for public consumption will be discussed during the conference by a representative of the Civic Federation and Bureau of Public Efficiency.

Proper accounting, and an approach to cost accounting should materially aid municipal credit. Too much local credit rests upon the tax-exempt feature of municipal bonds and not enough upon thorough-going analysis of the "going business" position of the local government. The emphasis should be reversed, - the going business position should govern, the tax-exemption be incidental. The importance of proper accounting to the investor will be discussed by a representative of the Investment Bankers Association.

Personnel

The importance of personnel cannot be overstressed. The best system breaks down without qualified personnel to carry on. One of the subjects for discussion in this conference is Local Government Personnel. There is a tendency to look to Civil Service to correct personnel problems. That is a mistake. The Civil Service alone will not provide the qualified public officer. As now administered, Civil Service does not attract the most capable men, nor does it protect from the spoils system. There ought to be devised some way to obtain appointments on merit without spoils or other political complications; perhaps nomination by a man's own professional group or other impartial and qualified group.

I am glad to say that throughout the depression years there has been a noticeable improvement in the personnel in municipal accounting offices. A recent survey showed that approximately one-third of the members of the Municipal Finance Officers Association now are graduates of recognized colleges and universities. It is most important that this development continue not only among the accounting officers, but throughout the personnel in our local governments.

Auditing

The importance of independent audits by qualified auditors should be stressed. One of the great evils in this regard is the practice of awarding audits on a competitive bid basis. The accountant should no more be engaged for this type of work on the basis of a competitive bid, than should the City Attorney or the Medical Director.

In a Supreme Court case in New Jersey, in connection with the requirement of bids for contracts over \$500.00 under the laws of the State of New Jersey, the Court ruled that accounting services did not come within such "bid" requirement. I quote the following from the Court's decision --

"We apprehend the services to be rendered under this resolution were of a character involving peculiar professional education

and experience which invariably have differentiated their possessor in the industrial, economic and social environment of life, from one possessed only of the capacity to furnish work and labor as those terms are commonly accepted. Such services are comparable in character with the special services of counsel, employment of a physician, or like expert service in the discharge of municipal administration requirements."

The National Committee on Municipal Accounting has taken the following position:

"It is recommended that in engaging auditing services, ordinary consideration be given to the qualification of the auditor to perform a municipal audit, preference being given to Certified Public Accountants."

The Committee further wishes to register its disapproval of awarding auditing contracts on a competitive basis. - -

The Municipal Finance Officers Association, in its volume Standard Practice in Municipal Accounting and Financial Procedure, states:

"In engaging auditing services, it is recommended that primary consideration be given to the qualifications of the auditor to perform a municipal audit . . . audit contracts should not be awarded on a competitive basis."

The importance of audits will be discussed by a representative of the Surety Association of America.

Educational Program

The public accountant must prepare himself thoroughly if he is to be helpful in this field. There is a great need to study municipal accounting, because it is fundamentally different than commercial accounting. So different that the ablest commercial accountant may encounter serious difficulties in making a proper audit for a local government. The accountant must at all times be thoroughly familiar with the laws under which the local government operates.

The finance officer should be a thoroughly trained accountant and must develop reports which will furnish all the facts regarding the governmental unit. The public must be educated to the realization that added functions mean added costs. Only by cooperation of all the groups involved will it be possible to arrive at any solution to this difficult problem.

THE BASIC PRINCIPLES OF MUNICIPAL ACCOUNTING
(Their similarity to and differences from
industrial and commercial work)

Lloyd Morey, C.P.A.
Vice-Chairman,
National Committee on Municipal Accounting

The American people are now spending between eighteen and twenty billions of dollars per year to govern themselves. Out of every dollar earned a quarter is required for governmental expenditures. Over 175,000 units of government share the responsibility for this expenditure. These units are of every conceivable size and complexity from the smallest rural school district to the Federal government itself. Local units are subject to the varying laws of forty-eight different states.

Even though governmental activities were unified the accounting required for them would be a man size job, but since they do vary so much in size and in character their accounting problems are all the more intricate and unique. Yet as in every business enterprise the accuracy of the result depends upon the system employed.

Every kind of business requires an accounting system adapted to its own needs and conditions. If you go into a bank you expect to find a different system from that employed in the department store across the street, the packing house, the railroad, the steel mill--each will require still a different procedure. In all of them the principle of debits and credits will apply and many other features of uniformity prevail. However, for each of them certain distinctive principles of classification must be recognized, if satisfactory results are to be procured.

The same thing is true of governmental bodies. The City Hall or the County Court House cannot follow the identical system employed by the bank, the railroad or the packing house, any more than one of these undertakings could be adequately served by a system fitted to a public enterprise.

Some years ago a treatise on municipal accounting made the assertion that the difference between private and public accounting was not a difference in purpose or in method. The only difference, it stated, was in the subjects concerning which information was needed.

"For both private and public institutions the principles which govern the technique of accounting are the same."

This point of view has led to many difficulties. It has resulted in financial statements for municipalities being prepared in commercial form attempting to show profit and loss, and stating a single figure of net worth or surplus. It has led to indiscriminate merging of funds, and to the inclusion of fixed assets with current assets as a basis for a single figure of surplus.

Only a few weeks ago the American Institute of Accountants published a volume entitled "Principles of Accounting". Neither in the title page nor in its contents was there any indication of its scope other than that revealed in the title, yet the volume dealt only with the accounts of private business. It made

no mention of many terms vital in the accounts of public enterprise, such as fund, appropriation, encumbrance, unappropriated surplus. The forms of financial statements described by it included only a profit and loss statement and a balance sheet suitable to a privately owned business. Thus even today there exists, even in informed circles of accountancy, a lack of recognition of the fact that public enterprises demand for proper accounting and reporting, procedures, terms and forms that are peculiar to them, and without which adequate and useful information cannot be provided.

If we start out to devise an accounting system for any enterprise, there are certain essentials to which we must give consideration. These essentials are not the size and form of the ledger sheet, or whether the work is done in pen and ink or on bookkeeping machines. The fundamental considerations are the terminology employed and the principles used. Only as these essentials are determined and recognized can a suitable accounting system be provided. As a recent article expressed it: "If your city is one that continues to publish one of those old fashioned expensive and jumbled annual reports listing each screw-driver bought but hiding a half million dollar deficit, you are safe in betting ten to one that it is not economically run."

The National Committee on Municipal Accounting set out to do what had never been thoroughly done before. First, to formulate the principles suited to governmental accounting and reporting; second, to develop authoritative definitions for the principal terms needed; and third, to devise suitable forms of financial statements. The first question that the Committee asked was: What, if any, are the differences between public authorities and private business? Second, if such differences exist, how do they affect the accounts and reports?

First of all public enterprises are not owned by individuals. Their very nature indicates that to be the case. Although all or many persons may be interested as citizens, they do not possess any interest as private individuals. Consequently in public bodies by contrast with private undertakings there are no accounts expressing proprietary interests of individuals, partners or stockholders. Instead a public body has surplus accounts expressing the extent of its resources over its obligations. But since each kind of resource in a public body is limited to some specific use separate funds are necessary, each of which is an individual entity with its own surplus or deficit. Consequently a public body does not have one figure of surplus but as many such figures as it has different funds.

In the second place a public body, except when it engages in some particular business of a commercial character, is not income producing, whereas a primary purpose of private enterprise is to produce income. Consequently in a public body accounts of income from its own activities are missing or may be of secondary importance. On the other hand, the majority of public bodies have a source of income represented by their power to tax, a power which belongs to no private undertaking.

In the next place, and in many respects the most important of all, a governmental body is not conducted for profit, whereas the main objective of every private business undertaking is the creation of a profit, and the avoidance of a loss. Unless a government engages in specific business activities, it is not concerned at all with profit and loss in the usual sense. Hence, the ordinary accounts and statements showing profit and loss are missing, except in self

supporting enterprises. Likewise many of the devices for the accurate determination of profit and loss such as the accurate allocation of all items of income and expense to specific fiscal periods through accounts of accrued and deferred items, and also the accounting of depreciation on real property become of little or no consequence.

Another important difference has to do with borrowing powers. In the private enterprise borrowing power is largely based on property owned. In a public body this ability is not represented by property but by its taxing power, and its ability to collect taxes. Consequently the current value of property is of little or no significance and there is little or no relation between outstanding liabilities and property owned. Public property is not ordinarily available or depended upon to meet debts or future expenditures. For that reason the accounts of real property in a public body must be kept distinct and separate from those of current assets, and the surplus which is represented by current assets from which expenditures may be made, must be at all times separated from that which is represented by permanent real property.

Another important feature of public bodies has to do with the many legal restrictions under which they operate. These restrictions are found in Federal and State constitutions, in Federal and State statutes, and in Municipal ordinances, as well as in administrative regulations. In many instances they affect in a vital manner financial operations. Particularly is this true in respect to the limitations placed on the use of the resources of a public body. This process results in a system known as funding. Whenever a tax levy or other source of revenue is created, which is earmarked for a specific purpose, a bond issue authorized or a gift received carrying such restrictions, a new fund is created. Each fund is a distinct and separate individuality and requires for its accounting a complete set of accounts within itself, and accordingly a complete balance sheet. No private undertaking is subject to such a condition.

Lastly public bodies set limitations upon expenditures (please don't laugh) which do not prevail in private undertakings. To enforce the limitations thus set upon officials by legislative bodies the budget system has been devised. A budget constitutes a complete financial program for a fiscal period that carries with it the authorization to incur liabilities and make expenditures, and sets a limit on the amount of commitment which may be made for each and every purpose. To effectively carry out a budget system requires the use of budgetary accounts in the general accounting system. While budgetary procedure is found to a moderate extent in private business, it is by no means as significant or universal as is true in public enterprises.

How then do these different features which are peculiar to municipal and other public bodies affect the accounting system? In the answer to this question are found the fundamental principles of municipal accounting.

1. The accounts must be classified in balanced fund groups.
2. A clear segregation must be made between the accounts relating to current assets, liabilities and operations, and those relating to fixed assets and liabilities.
3. The general accounting system and reports should include budgetary control accounts for both revenues and expenditures.

4. The accrual basis of accounting should be applied to revenues and expenditures as far as practicable.

5. The accounts of business enterprises conducted by the government should be carried out along the same lines as those of similar enterprises under private ownership. In other words, so as to determine the true results of operations in each case.

6. Property, other than that of business enterprises, should be carried in the accounts and reports at cost, without allowance for depreciation.

One further principle needs to be added: a common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports. These instruments constitute the "big three" of public finance and should form a continuous cycle. They become most useful when they follow a uniform plan of concept, so that each is used to supplement and serve the other. All too often the budgets of local governments are lacking in fundamental qualities of fund classification, accurate estimates and correct terminology. Too often the financial report, especially when prepared by outside auditors, fails to follow the budget or to reveal information necessary to exhibit the results of budget operation.

So much for some of the highspots about the accounting system itself. But the accounts are of little significance except as they produce information, which is useful in meeting administrative problems. Financial statements constitute the medium by which this information is made available. How do the peculiar qualities of public bodies affect their financial statements?

First of all as to the balance sheet. A balance sheet is needed for a public enterprise the same as for a privately owned business, but the public balance sheet must be subdivided by funds. It must show distinctly the assets, liabilities, surplus or deficit of each fund. There must be no consolidation in which the facts relating to each fund are not clearly shown. There is no single figure of net worth in a public body, and no financial statement which combines, in the manner all too frequently stated, expendable surplus with surplus which is invested in fixed assets can be anything but misleading.

Next as to income and expenditure statements. Such statements should provide a classification of these items corresponding to that in the budget. It should show comparisons with budget estimates so that the results of operation under the budget may be revealed. It should show clearly whether the revenue has exceeded the expenditure or the reverse, and for that purpose should include only items which are revenue or expenditure, and not, as so many municipal financial statements do, be merely a statement of receipts and disbursements, in which money received from the sale of tax warrants is hopelessly confused with that from actual revenues.

In the next place the statements of surplus must allow for incumbrances in the form of orders and contracts outstanding but unfilled. Surplus in government means that sum represented by liquid or realizable assets which is available for appropriation and expenditure, after allowing for all commitments and other necessary reserves. As already emphasized the surplus or deficit of each fund must be stated separately.

In addition to these fundamental statements there are, of course, many other statements necessary showing the operation of special funds, facts about bond issues, tax levies and other important matters. The financial report of a municipality or other public body in the main must answer the same questions that are asked of any financial report of a private organization, namely, what are the results of operation of the period covered by the report, and what is the financial condition at the date of the report? To answer these questions, however, requires forms of financial statements different in many respects from those of a private organization, and also many statements not necessary for a private business.

It is this very fact, coupled with the inevitable complexity of public financial statements that has made both public officials and citizens dissatisfied and lacking in confidence in public accounts. The complaint is often made of public accounting systems that they are too complicated and that they cannot be understood by the average citizen. Public finance is necessarily complicated. It lacks the simplicity of the average private business. Where many funds are involved, each of which is a separate fiscal entity and requires different methods of treatment to express its results and conditions, the accounts, as well as the financial statements, must have a certain degree of intricacy, otherwise they are incomplete and inaccurate. Public accountants and public officials can do much to overcome this condition by letting legislators, officials and citizens know the conditions and by giving them suitable explanations of the peculiarities of the various funds, and by presenting statements answering the fundamental questions as directly as possible and at the same time in terms that mean the same thing whenever and wherever they are used.

This conference is concerned primarily with the problems of municipalities; one of the most important divisions of local government. Local government, in spite of its faults and failures, is still the most important and useful division of our public agencies. It deals most directly with our daily lives, serves our essential needs most closely, and expends by far the largest proportion of our taxes.

If it is to survive, however, the financial management must be improved. Financial considerations enter into every problem with which local government has to deal. Unless those considerations are based upon sound judgment, honest motives and accurate information local government ultimately will fail. Only by an adequate system of accounting and auditing can these noble objectives be made secure.

This is our responsibility and our goal. The recommendations of the National Committee are intended to lead in that direction. No one assumes that they are the last word on the subject or that they must be applied in an inflexible way to every situation. Problems must be solved in the light of existing laws and local conditions. It is only general principles and terminology which we can hope to establish on a broad basis. With these as a foundation, however, the rest hardly can fail ultimately to follow.

Note -- During the presentation of this paper the author referred to a number of published reports of public bodies which represent an application

of the National Committee recommendations. Those mentioned were as follows:

Annual reports - Topeka, Kansas
Salt Lake City and County, Utah
New Rochelle, New York
Norfolk, Virginia
Greenwich, Connecticut

Monthly reports - Pontiac, Michigan
Tulsa, Oklahoma
(American Institute examination, May, 1937)

Utilities - Topeka, Kansas
Jamestown, New York
Kewanee, Illinois

THE PRACTICAL APPLICATION OF
MUNICIPAL ACCOUNTING PRINCIPLES

George D. Bailey, C.P.A.

It is only recently that it has been possible to refer to "Principles of Municipal Accounting" with any assurance that the reference would have a concrete meaning. Now, as a result of the efforts of the National Committee on Municipal Accounting and its advisory committees, not only has there been a clear enunciation of the fundamental principles of municipal accounting, but, thanks to many articles, books, talks and discussions, I believe there is a general understanding and acceptance of those principles so enunciated. So, in discussing today The Practical Application of Principles of Municipal Accounting, I can without hesitation confine my remarks to the Principles set forth by the National Committee.

The principles seem to me to fall into two classes. The first class includes those that involve no technical problems in their application, and which are so fundamental as to be applicable to practically all situations. The second class comprises those rules which are either stated in such a manner as to allow considerable latitude in their application or must be considered as somewhat flexible.

In the first class fall the following principles: (condensed for reference).

- (1) The accounts should be centralized under the direction of one officer.
- (2) The general accounting system should be on a double entry basis.
- (3) The accounts should be classified in balanced fund groups.
- (4) A common terminology and classification should be used throughout all the records.
- (6) A clear segregation should be made between fixed asset and liability accounts and others.
- (11) The accounting for municipal business enterprises should follow the standard classifications employed by similar private enterprises.
- (13) There should be general uniformity in the financial reports of municipalities of similar size and type.
- (14) At least once each year a general financial report should be prepared.
- (15) A periodic audit by independent accountants is desirable.

In a limited paper such as this, the foregoing principles need little discussion. The variations of state laws and city charters would seldom cause

modification. I do not want to dismiss them, however, without at least a few comments.

I thoroughly believe in the general principle of concentration of accounting responsibility under one officer. This is the only satisfactory way of getting good accounting at a minimum of cost. This need not, of course, prevent the keeping of necessary records in the treasurer's office. It does contemplate, however, that the accounting for the utilities and hospitals and similar activities as well as the general city departments will be included within such concentration. Concentration demands that there be a clear-cut auditing procedure, not only for current detailed transactions but for the periodic presentation and approval of financial statements and an adequate system of internal check is essential. In large municipal units the auditing function should be separated entirely from the accounting function. In smaller units, the independent department for continuous audit is not possible, but it is usually possible to arrange for some internal check. With responsibility concentrated, outside independent audits are essential to adequate control.

The accounts should be kept in balanced fund groups. However, we must recognize that this balanced fund principle of presenting accounts differs so substantially from commercial accounting practice that it is but little understood. Very few business men have any understanding of municipal reports so prepared and laymen with no training in financial statements get even less from the reports. Even that part of the public which does understand something of accounting has difficulty in interpreting municipal statements. This does not mean that the balanced fund principle is wrong, but it does mean that much work remains to be done with respect to it.

Part of the work must be in education of the general public, and even of the accountants. Much, however, may be accomplished by study of the best way of presenting the balanced funds. It has seemed to me that part of the trouble is that the relationship of the various funds to each other is not brought out. I myself like a columnar presentation of funds leading to a combined column, and believe the objections to a combined column can be largely overcome by earmarking assets and segregating surplus. It does seem preferable to have a combined column even though somewhat misunderstood to have as little understanding of the statements as there now is. On the other hand, I do not favor submission of the combined column alone. If a brief explanation of the fund principle could accompany each public presentation of municipal accounts, or if the relationship between the funds could be explained, it might help to develop a better understanding.

Balanced fund accounting requires a careful recognition of the integrity of the individual funds. There is, however, the problem of how far it is practical to carry out the complete independence and integrity of each fund. For instance, should the fire protection department in the General Fund be charged with the cost of maintaining the high pressure water system, and the water department given credit? Should a utility be charged with taxes on its property, and for the use of streets? Obviously, the extent of independence and integrity must be based upon a practical analysis of the requirements of each municipality, but emphasis should be on the side of accurate accounting between the funds.

A clear segregation between fixed and other accounts does not necessarily require different balance sheets. In small units, and perhaps some other

special situations, there might be no objection to showing fixed liabilities and perhaps fixed assets combined with the General Fund provided there could be a clear disclosure of the availability of assets and a segregation of surplus.

I come now to the second group which comprises the remaining principles, which are stated for reference as follows (condensed):

- (5) That eight fund classifications be used.
- (7) That the general accounting system include budgetary control accounts.
- (8) That encumbrances be set up as incurred.
- (9) That the accrual basis be used as far as practical.
- (10) That depreciation be not taken on general municipal fixed assets.
- (12) Inventories and fixed assets should be kept in subsidiary records controlled by the general accounting system.

It is in connection with the foregoing principles that most practical problems arise, and where modification must be made because of statutory provisions, or size, and where good judgment is important in their application. In applying these principles to the accounting of a municipality, sight must never be lost of the final objective - intelligent and understandable presentation of financial affairs. The amount of detailed information to be gathered or published must be considered in the light of the usefulness of the information compared with the cost, and with the capacities of the personnel either present or potential to gather the information accurately. Time permits only a brief reference to a few of the more important practical problems.

The recommendation is for eight classifications of funds. The general theory of the division is sound. In larger enterprises such a classification may be necessary and may even require elaboration. For instance, utilities separately operated should probably not be combined into one utility balance sheet. On the other hand, a multiplicity of funds generally adds to the confusion for all except the technicians. The emphasis should at all times be toward the minimum number of funds. To set up a separate fund for one trust account would seem to be entirely unnecessary. A complete compliance with the fundamental principle would be met by a separation and earmarking of the asset and an offsetting account so that the trust fund would not be included in the general surplus. With several trust or agency funds, it is desirable to have separate fund accounting. The availability of the trust income is also a factor to be considered. Working capital or revolving funds need not always be separate funds. It may sometimes be preferable for a revolving fund to be carried within another fund classification, if the activity of such other fund gives rise to the revolving fund. In some cases it may be preferable not to show the details of the revolving fund, where unimportant. In other cases it may be advisable to close out the revolving fund accounts at the close of the accounting period, and substitute the accounts for the assets and liabilities themselves; in others, to show the details of the revolving fund in supporting schedules, rather than in separate funds.

The foregoing comments are illustrative only. They are not to be considered as criticising the rule but rather as pointing out that the rule need not be followed slavishly. The principle is maintained if the suggested funds are contracted or expanded in the interest of clarity of exposition.

The general accounting system should include budgetary control accounts for revenues and expenditures. The soundness of the principle is unquestionable, but it must be recognized that in some small units the inevitable complication of the bookkeeping required by that rule is hardly justified or even safe, and that an independent budget record which can be proved to the general accounts may be permissible. The classifications of revenues and expenditures must be the same for both the general accounts and the budget.

The entering of purchase orders and contracts as encumbrances is sound theory but must be subject to a practical test depending upon the nature of the liability. This problem must be tested from the standpoint of usefulness, importance of disclosure, and budget requirements.

I touch on the depreciation question very lightly, and with some trepidation. The stated rule is that depreciation need not be considered for general municipal property. Does it follow that it should be considered for utilities? Can not depreciation be proper and necessary for some municipal utilities under some circumstances and not in other circumstances? Should depreciation be considered for activities existing by virtue of rates instead of taxes? Granting the advisability of depreciation charges in certain cases, is the depreciation to be calculated by the retirement method, by the useful life method, or measured by the amount of sinking fund and bond maturity requirements? Depreciation is not a theoretical but a practical problem, but it seems to me that a supposedly self supporting activity which requires constant and frequent expenditures for enlargement and replacement of fixed assets will inevitably complicate the financial problem of the municipality unless some provision is made for or in lieu of depreciation.

I should like to touch on some of the practical difficulties in the process of recording and controlling inventories and fixed assets, but the problem can hardly be outlined, and must be left for another time.

I have left until the last the discussion of the accrual basis. Number nine of the Principles of Municipal Accounting states "that the use of the accrual basis in accounting for revenues and expenditures is recommended so far as practical. Revenues, partially offset by provisions for estimated losses, should be taken into consideration when earned, even though not received in cash. Expenditures should be recorded as soon as liabilities are incurred."

The accrual basis to most people means an accurate recording of items as in commercial enterprises, in order that expenses and revenues may fall in a proper period for accurate determination of profit or loss, and that all assets and liabilities may be carefully set up. Also, to most people the accrual basis means an accounting for all expenditures for fixed assets, and since most municipalities considering modern accounting do not have accurate property records, it seems to require an appraisal of all municipal property.

But the rule recommends the application of the accrual basis only so far as practical. I, myself, prefer the term "semi-accrual basis" as being more descriptive of the usual practical application of the accrual theory. Municipalities, except for some utilities, do not need to determine monthly profit and loss,

or even revenue and expenditure statements with meticulous accuracy as between months, nor is it usually necessary to have accurate monthly accrual of all liabilities. But a certain very definite minimum of accrual accounting is necessary, and is as essential for municipalities as for commercial enterprises. The financial position of a municipality is not measured by the cash on deposit, but by the relationship of that cash to floating debt, to encumbrances, and to currently collectible amounts owing to the municipality, and it is quite as important to record the amounts due to or from other balanced fund activities as to outsiders. Financial progress is not measured by the comparison of cash balances alone, but by comparison of cash and other items, particularly the liabilities.

As a minimum, an accrual basis should be applied to such items as are necessary for the determination of financial statements, for the inclusion within the period of the liabilities belonging to that period, for the disclosure of encumbrances outstanding at the close thereof, and for the recognition of the assets owing to the municipality or to the particular fund. For many small situations it seems to me that it is entirely proper to carry the accounts from day to day and from month to month on a cash basis and carefully record at the close of the period the receivables and payables necessary for proper disclosure of financial position. Even for larger units, it may be found in many cases unnecessary and inadvisable to accrue ordinary and constantly recurring items from month to month. In most cases it will not be advisable to accrue each month's interest expense, for instance, or each month's insurance expense. On the other hand, it will be advisable to set up the tax levy with a reasonable provision for loss and to set up the budget appropriations in order to account properly for the receipts of taxes and the disbursements and encumbrances on appropriations as they occur.

The extent of the application of the accrual system is a very practical problem. It must be considered in the light of legal requirements and legal restrictions, the personnel and its ability to handle the accounting involved, and the importance of the periodic statements as compared with the year-end statement. Even at the end of the fiscal period there is room for discussion as to how far the accrual system shall be carried through. Ordinarily one is tempted to answer by stating that all expenditures covered by the year's budget or intended to be covered in that budget are, to the extent unpaid, to be accrued at the close of the period. However, that is sometimes equivalent to saying that interest, pay rolls and ordinary running expenses payable immediately after the beginning of a new fiscal period are not to be accrued if it is intended that such accounts are to be paid from the new year's levy. Obviously, such a procedure does not and can not reflect truly the financial position of the unit because the benefit of such expenditures fell within the previous fiscal year. Ordinarily it seems to me that accrual accounting should be applied at least to the extent of disclosing as liabilities, interest, pay rolls, and running expenses due immediately after the beginning of the new year. This point can perhaps be illustrated by the case of a municipality having substantial interest payments coming due the first day of the new fiscal year, where the procedure in connection with the budget has been to consider such interest as a charge against the new levy. However, since the cash for the payment of that interest must be definitely in hand before the first day of the new year, such procedure would have the effect of showing the cash balance without the corresponding liabilities. Thus, it could well happen that the entire amount of cash instead of being available for general purposes is required for the interest liability. Furthermore, the failure to include interest payments of the first of the new year in the previous

year's budget in most cases forces short term borrowings over the end of the period and further distorts the showing. Therefore, while interest, pay rolls, and miscellaneous regular purchases may be treated on a cash basis during the year, it seems to me essential that they be treated on an accrual basis at the close of the period to the extent of the amounts due immediately after the close of the year.

I think it is necessary always to keep in mind the ultimate purpose which is sought in the use of the accrual basis and to constantly test the extent of the accrual not only from the standpoint of accounting accuracy but also from the standpoint of understandable and useful statements. Incidentally, I suggest that published reports carry a disclosure of the extent of the application of the accrual system.

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This discussion should be considered rather as an outline of the practical problems than as an extensive exposition of them. The entire time could be used in discussing the practical aspects of each principle. Definitely, I am not criticising the principles, but it does seem to me to be important to have a clear understanding of the flexibility inherent in the enunciated principles. Perhaps now that the principles themselves are reasonably well crystallized, we can hope for a wide discussion and for many articles on the practical aspects of each of the principles.

USE OF ACCOUNTS IN MAKING AND CONTROLLING MUNICIPAL BUDGETS

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One of the important respects in which governmental accounting differs from commercial accounting is the use of so-called "budgetary" accounts. These are special accounts set up to express estimates and authorizations imposed upon the transactions of various municipal funds by statute or charter or as the result of limiting decisions made by the people or by city councils. They reflect the budget as finally and legally adopted. They provide also for control over the general and departmental administrative officers in the execution of the budget.

The regular accounts, which provide the record of transactions and which analyze revenues and expenditures, also are needed to furnish the historical material that must be included in a budget in its preliminary stages.

Budget Classifications Should Correspond with Account Classifications

Theoretically, a budget should present a two-way classification of revenues and a five-way classification of expenditures. Besides the primary division into funds in both cases, the revenues will be classified also as to source and the expenditures as to organization unit, function or activity, character and object. It is obvious that such revenue and expenditure analyses cannot be made in the budgetary comparison of past and proposed transactions unless the book accounts are set up according to the same classifications. Most of you, no doubt, are familiar with instances where new state legislation has prescribed uniform municipal budget classifications and estimate sheets covering any where from two to four years of past experience. Where this was not supplemented by uniformity in the local accounting systems, the supervising budget officers have learned, to their chagrin, that the budget control law was difficult, if not impossible of enforcement. It should be recognized that the accounts are necessary tools for budgeting and that a uniform system of budget classifications and estimate sheets needs a uniform accounting classification to implement it. Where there is variety in local accounting systems, which is the actual state of affairs in most of our home rule states, uniform budget set-ups must be worked into gradually.

Budgetary and Proprietary Accounts Integrated

Most of the writers, and the National Committee on Municipal Accounting recommend the inclusion of the "budgetary" accounts with the so-called "proprietary" accounts in a single balanced set of accounts for each fund. On the revenue side, the purpose of the budgetary account or accounts is to record the authorization or the estimate over, against, and in advance of the actual accrual or collection of revenue. On the expenditure side, the purpose is to record the spending allowance for each department, function, character, or object as set forth in the limiting appropriation ordinance and in advance of the actual incurring of obligations.

General Fund Example

Let us take the General Fund of a city for example. The estimates and authorizations on the one hand, and the actual income and outgo on the other, are represented by couplets of accounts. For revenues the actual accounts have credit balances, and the estimate or budgetary accounts have debit balances. For expenditures the actual accounts have debit balances and the estimate or allowance or budgetary accounts have credit balances. Sometimes there will be a short cut in the accounting procedure, and actual revenues will be credited to the Estimated Revenue account, and actual expenditures will be debited to the Appropriations account, but the preferable procedure is to have the estimates and the actualities separated in the accounts, bringing them together for necessary comparisons in the operating statements and possibly also in the balance sheets. The two accounts of Estimated Revenues and Appropriations are both control accounts supported by subsidiary ledgers which provide the standard, detailed classifications of both revenues and expenditures. This will correspond to the relationship between the Revenues and Expenditures accounts and their respective subsidiaries. If appropriations are not finely segregated, but are more or less lump sum in character, it will not be necessary to support the Appropriations account with as great detail as will be needed in the analysis of Expenditures.

Allotments

An adjunct of the budget system in some cities is the establishment of allotments by which the annual appropriations by the council are subjected to re-allocation, usually by the chief administrator, on the basis of monthly or quarterly programs. A system of allotments, like appropriations by the council, needs to be reflected in the accounts. An account for allotments is a credit account to which the appropriation balance is periodically transferred during the year.

Encumbrances

Another feature of municipal budgeting and expenditure procedure which requires special accounts is the matter of encumbrances. In most cities the appropriation or allotment accounts are required to be charged or "encumbered" when an obligation is first incurred. To prevent the incurring of obligations beyond available allowances, the finance officer is usually required to certify on contracts and purchase orders about to be issued that there are unencumbered balances of appropriations or allotments available to meet the same when they reach the stage of disbursement. The encumbering process is represented, according to the National Committee recommendations, by a couplet of accounts called Encumbrances and Reserve for Encumbrances. When the obligations covered by these accounts actually become claims payable, or are paid and directly charged to the Expenditures account, the appropriate entries in these two encumbrance accounts must be reversed. The balances in them will at all times represent only the outstanding or unliquidated encumbrances.

Occasionally, encumbrances will be taken into account by an informal or short-cut procedure. One such method is the entry and check-off of encumbrances on the subsidiary appropriation ledger sheets without journalizing and entering them into control accounts. Another is a file of pending, outstanding purchase orders or contracts which may be classified and totaled for listing as encumbrances on the periodic expenditure statements. But, even with such short-cuts, it is necessary to make orthodox entries in the encumbrance accounts at the end of the year.

Entries

In using the budgetary accounts to record the adoption of a budget, the following journal entries are involved:

- (1) Debit: Estimated Revenues
Credit: Unappropriated Surplus

- (2) Debit: Unappropriated Surplus
Credit: Appropriations

As recommended by the National Committee there may be two accounts for estimated revenues, one for Estimated Tax Revenues, and the other for Estimated Miscellaneous Revenues.

As revenue accrues or is collected during the year, credits will be built up in the actual revenue accounts, being offset by either cash or receivables. As obligations are incurred and expenditures made, there will be, first, entries in the encumbrance accounts, and later, entries to the Expenditures account, with the encumbrance entries reversed. The debit to Expenditures will, of course, be offset eventually by the credit to cash. As stated before, the balances in the estimated revenue and the appropriations or allotment accounts will remain unchanged during the period unless adjusted by the appropriating and allotting authorities.

Operating Statements

The comparison which is so essential between the estimates and the actualities will appear in the revenue and expenditure statements that must be periodically provided by the accounting department to the administrative officers and the council. For revenues, such a statement would show, for each fund and classified by source or type of revenue, the estimate for the period, the realization to date, and the unrealized balance to date. For expenditures, the statement would show, for the various subordinate classifications, the appropriation allowance (perhaps also the allotments and the unallotted appropriations to date), the expenditures to date, the encumbrances and the unencumbered balance of the appropriation (or allotment).

Balance Sheet Picture

On a balance sheet picturing the condition of a general fund at any time during the year, before the budgetary accounts are closed out, the relationship between the estimate and actual accounts might appear as follows:

On the Asset Side

Estimated revenue	000	
Less realized or collected to date	<u>000</u>	
Unrealized estimated revenue to date		000 •

On the Liability Side

Reserve for encumbrances		000
Unallotted appropriations		000
Allotments to date	000	
Less expenditures to date	000	
Less encumbrances to date	<u>000</u>	<u>000</u>
Unencumbered balance of allotments		000

In closing the budgetary accounts, as well as the actual revenue and expenditure accounts, all are closed to Unappropriated Surplus. The only account carrying over to the next year would be the Reserve for Encumbrances. Expenditures on these held-over obligations would be charged directly to this reserve account rather than to the new Expenditures account.

I have said that the estimates and actualities are brought together in the operating statements throughout the year. They are also brought together on the subsidiary ledger sheets, where for each item of the appropriation there will be shown in proper relationship the appropriation, the allotments, the encumbrances, the expenditures and the balances. The subsidiary ledger sheet has many forms and may be designed to take advantage of machine accounting. The entries may be made only monthly in the control accounts but on the detailed ledger sheets they must appear currently. These subsidiary ledger sheets, although tied to the various control accounts, are really the most important working tools of the finance office in the execution and control of the budget.

A word should be said about the surplus account. The National Committee uses the term Unappropriated Surplus. It is obvious that when a revenue estimate is credited to this account at the beginning of the year, the account does not represent in an orthodox sense the excess of actual assets over actual liabilities. Some commentators have criticized putting this element of uncertainty into the surplus account and have suggested some other title, such as "Unappropriated estimated revenue". The National Committee's terminology with reference to the couplet of accounts for encumbrances has also been criticized. The important thing, however, is to get some uniformity in terminology and an understanding as to what is meant by the accounts.

Other Funds

The previous discussion of the use of budgetary accounts has had reference to the general fund. There may be similar accounts, with somewhat different titles but having the same objectives, in the accounts for other funds of the city. Whether these accounts are necessary depends upon which funds are subjected to the budgetary process and control. Often when the decision concerning revenues and expenditures is made by other parties than the city council, such as the people voting in a bond referendum or the benefited property owners petitioning for local improvement, the funds may not be included in the budget. Almost everywhere the general fund and the special revenue funds are budgeted. Sometimes the utility funds are budgeted and subjected to appropriation control. Bond funds occasionally are budgeted; the same may be said of sinking funds. But whether or not they are actually subjected to appropriation control, there should be provided in the case of both bond funds and sinking funds, as well as special assessment funds, appropriate accounts to represent the legal authorizations for revenue or expenditure. The accounts suggested by the National Committee for these funds are as follows:

<u>Fund</u>	<u>Debit Account</u>	<u>Credit Account</u>
Bond Fund	Bonds Authorized and Unissued	Reserve for Authorized Expenditures (or Balance)
Special Assessment Fund	Improvements Authorized	Reserve for Authorized Improvements
Sinking Fund	Sinking Fund Requirements	Reserve for Bond Retirements

If any of the foregoing three funds are subjected to appropriation control, there would also be included in the setup for each fund an Appropriation account.

When accountants use the terms budget-making and budget-control, they think particularly of these special "budgetary" accounts we have been describing; but, as stated at the beginning, virtually all the regular accounts have a direct or indirect relation to the budget. Even cost accounts have important uses in connection with municipal budgets. Municipal accountants and auditors, therefore, need to be thoroughly conversant with the budgetary procedures and legal limitations applicable to the municipalities which they serve as officers, employees, or clients.

ACCOUNTING REPORTS AND MUNICIPAL CREDIT

John S. Linen
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Investment Bankers Association of America

Accountants and security dealers while operating in entirely separate fields of endeavor continuously find much in common and that their ultimate objectives are directly along the same line if not identical. It would accordingly seem that somewhat frequent exchanges of ideas and viewpoints should tend to a better understanding of the purposes of each group and the reasons supporting them.

You will, of course, understand that I am unable to talk with you as to the technique of accounting, its systems, etc., - you are experts in that field. I will necessarily have to limit myself to its general application in the municipal field and its value from the standpoint of credit as measured by investors, dealers and others interested.

Boiled down, the actual worth of municipal credit depends on its measurement by investors. For the facts and material used in arriving at their conclusions, investors look to municipal dealers and service organizations. These in turn, of course, depend upon the material facts that can be gathered both from and concerning the municipalities. This may seem unnecessarily elementary. It is stated, however, for the purpose of refreshing our minds as to the relationship of one body to another.

Municipalities desiring to improve their credit worth can obtain considerable help through both accountants and dealers. A closer understanding and working arrangement between these two groups might be developed with advantage to all concerned. Accountants are naturally pleased to be associated with municipalities enjoying high credit positions or with those constantly striving to improve their standing. Dealers quite obviously are also pleased to be connected with the financing of such municipalities and can be of material assistance in developing the credit position where the underlying situation and facts are favorable.

Important to dealers in their study of various situations is completeness and clarity of financial statements. I have before me a form "Report on Finances" which was prepared a few years ago by the municipal men of the Investment Bankers Association. It is arranged to indicate the form of financial information sought by dealers in their study of an issue. It is briefed for simplification and ease of preparation to less than four pages. Even in this reduced form municipal officials are apt to question the need and value of supplying all of the information requested and frequently short-cut it. Where it is furnished in full the dealer can study the situation more completely and satisfactorily. He is in a better position to analyze the financial status and to present the accurate facts to investors.

The careful preparation of such material along with additional information which may in particular instances have important bearing on the position of the issuer, is deserving of careful attention by municipal officials. The form and thoroughness of auditors' reports may be of great assistance to municipal officials in supplying the necessary data for their reports.

The form outlines the essential particulars desired with respect to the following important factors:

- Property Valuation
- Bonded Debt
- Over-lapping Debt
- Conditions of Sinking Funds
- Principal Requirements for Next 5 Years
- Unfunded Debt Outstanding
- Comparative Statement of Operating Receipts and Disbursements
- Tax Data
- Tax Collection Report
- Tax Title Liens
- Tax Limits, etc.
- Special Assessment Collection Report
- Bank Deposits and Other Pertinent Data

It may be of value to comment briefly on these various factors so that a better understanding will exist as to why some of them at least are deemed important.

There is at times a wide difference between the assessed valuation of the taxable property as officially reported and the real, actual or fair market value of such property. In some cases the assessed value may be only a fraction of the actual value and in other cases it is found to be considerably in excess of actual values.

There is an unfortunate lack of uniformity in assessing real property. This is true not only within the same states, but it is frequently found that a variety of standards are applied within the same county. A school district that is practically coterminous with a municipality may be assessed on one basis and the municipality on another. Obviously, with such an absence of uniformity in the basis of assessments, it is difficult to measure debt ratios on any comparable basis unless some reasonably accurate figures are given as to the actual values so that proper adjustment can be made.

It is desirable that assessments be uniform within a county and that an adequate department of assessment be set up in each county for the purpose of assessing and continuously adjusting values with a view to equalizing such values in relation to market changes.

Bonded debt should distinguish between general obligations, special assessment debt and revenue obligations. The last type of debt is becoming increasingly important and should be divided into revenue debt which is also general obligation debt, and that which is payable solely from the special revenues available or pledged.

In connection with overlapping debt; there is the tendency on the part of municipal officials, and it is quite natural, to consider that in their offerings of securities the financial status of their own corporate body is the sole factor that need be given consideration by prospective purchasers. It is, of course, the prime factor, but the debt of related bodies for the payment of which levies may be made upon the property within the boundaries of the issuing corporation must also be carefully measured, and its effect upon the ability of the issuing body to pay given consideration.

It would be of very considerable value to all concerned, and accountants can be of great help in gradually bringing this about, if municipalities would put into effect a system whereby at periods of say once or twice a year they would, in collaboration with their related bodies, determine the net debt of the overlapping taxing bodies and the share of such net debt for which the taxable property of the particular municipality is liable.

With such a system in effect a municipality about to offer an issue could quickly bring the information up to date. It would then be available upon request or for inclusion in the announcement or notice of sale of a new bond issue, if desired.

It is possible that some tie-in with a central body such as a state auditing department or the Department of Audit and Control which renders an invaluable service in New York State, is the best solution to this problem. Because few states enjoy the benefits of such a well operated and staffed department, the need for such a service is the greater.

This would not only be of value in the marketing of new issues, but in supporting the secondary market as well, which must be recognized as having a material effect on the primary market.

Many cities are overlapped in part or completely by districts such as school, park, sanitary, etc., and in some instances other subdivisions, each operating independently of the other, each with its own governmental organization with power to incur debt, impose and collect levies to service it and to cover operating costs.

Generally under these conditions there is a great deal of duplication of operating costs which is unnecessary and in the interest of both economy and efficiency might be eliminated by consolidations of one kind or another.

Through scientific studies by accountants, surveys might be made available reflecting results under existing arrangements and for comparison, results possible after consolidating one or more or perhaps all of the overlapping bodies.

It seems to me that in many cities constructively minded officials and taxpayers would feel that the possibilities of substantial savings in years to come would warrant the expense of preparing surveys of this kind.

Such surveys would probably be made for taxpaying bodies or citizens' groups and it offers an opportunity for a high order of intelligence and constructive thought and service.

Sinking funds should obviously be maintained on a basis which will assure provision for the obligations at maturity or comply with such terms as the law determines. On occasions the trust relationship is not adequately recognized by municipal officials or obligations have been purchased which, because of their character, raise the question of liquidity or proper synchronization of maturities.

In attempting to estimate the probable needs of future financing, experience has demonstrated the value of capital planning programs so that an orderly approach to this whole problem can be made. Under these circumstances, public improvements are advanced on the basis of their relative importance one to the other, instead of

by a hit or miss policy which frequently favors special interests as distinguished from the broader public interest.

During the early 1930's when our municipalities experienced greater financial difficulties than has been true in recent history, probably than ever before in fact, it was found that temporary obligations, tax obligations and unfunded debt, were in many cases important factors in either creating the problems or greatly complicating the solution. Such debt should, therefore, be clearly set forth and its character understood.

It is recognized now that too little attention in the past was paid to current revenues and expenditures and the cash balance of these items. The grouping of such items under appropriate headings on the income and expenditure sides gives a valuable picture of relationships, one to the other, and an indication of trend which at times may be most significant.

Tax data including a record of tax collections for at least the last three and preferably five years, is helpful in showing the dependability of income from this important source. It is of value to have not only a record of the collection against the current levy, but on delinquent taxes as well. In this connection, information regarding the regularity of tax sales is desirable as is also the question of whether or not tax title liens are usually acquired by the municipality or sold to outside parties and if the former, the amount of such tax liens that are held by the municipality.

Legislation which places a limit on the ability to tax, particularly if such limit applies to debt service as well as operating costs, must be scanned with particular care by investors. Bonds that are payable from limited tax levies do not enjoy the best credit position and it is the custom to give evidence of such a limitation to investors by referring to the same in the offering circular.

There are many obligations outstanding that are payable primarily from special assessment taxes which are general obligations of the issuing municipality and as such, payable ultimately from general taxes. Accounting or budgeting procedure has frequently been faulty in connection with such bonds as assumptions have been made regarding anticipated special assessment tax collections which previous experience could not support and deficits have followed as a result. It is better policy that provision be made for such obligations in the general tax levy with deductions applying only when assessment collections are actually in hand.

There are times when it is of value to have information concerning bank deposits, whether or not they are secured and if so, in what manner.

In addition to the items commented upon in regard to the "Report on Finances", I should also like to mention briefly the question of relief and welfare expenditures.

Less progress has been made in solving the relief problem and the burden it places on the financial structure of municipal government, than most of us had hoped for after five or more years of experience. As time has passed it has become rather apparent that a sound policy requires that such costs be treated as current operating costs rather than those that might properly be funded even for a short period of time. The correct treatment of this item is an important factor,

particularly in those cities where the debt burden is already heavy and where a large population or a highly industrialized community makes, or threatens to make, the problem acute.

The above discussion has been pretty much in general terms. It may be of advantage to refer to one or two specific cases which will illustrate some of the above points.

An example of the results of what apparently was lack of advanced planning is found in recent developments in one of the larger eastern cities. There tax-payers are about to be confronted with a sharp increase in tax levies over the preceding year. It is reported that the rate for 1938 will amount to about \$16.40 per \$1,000 more than was required for 1937.

The city deserves credit for immediately providing for all of its mandatory requirements. The point in mind, however, is the probable extent to which this sharp and sudden up-shift in levies could have been avoided or graduated had there been a clear concept of the aggregate problems as they were building up and of the general trend of affairs. In other words, results might have been quite different had there been advanced planning of both current and long-term budgetary requirements.

A very interesting situation and one well worth mentioning is found in the contrast of results in the operating methods applied by the City of Detroit up to 1933 and since that time.

In review, the trend in tax collections first became evident in 1926 when the budget requirements were substantially increased. The tax budget was continued in an upward path and with it the percentage of collections diminished each year. By 1932 the city faced serious financial difficulties because of its inability to collect taxes and early in 1933 defaulted.

A thorough and intelligent study of its problems was made and its operating policy drastically changed beginning with the close of its fiscal year 1933. The results were remarkably good. The percentage of collections of current levies started to rise immediately and have continued to increase each year since then. Arrearages have been reduced some \$26,000,000.00 since the present operating practice was put into effect. Bond holders experienced no loss as a result of the default which has long since been cured by a general refunding operation.

The structure that reflects sound financial operations and planning is one that impresses and accountants can play an important role in this connection.

Through the preparation and presentation of factual material the way toward a constantly improving status can be indicated. Where such presentations are clear and evidence studied thought, they become both the base and a guide for current and long-term planning. They are helpful to the administrators and are frequently instrumental in ultimately accomplishing the sought-for improvement.

About a year ago the Committee on Accounting of the Municipal Finance Officers' Association issued, in pamphlet form, a report which they prepared relating to standard practice in municipal accounting and financial procedure. It was intended primarily for state and local officials. It has been found of value, however, to accountants and others interested in municipal finance and it is deserving of your study.

You may be interested in a program of model legislation now being undertaken by a special committee of the National Municipal League. I will take a few moments to outline it briefly. Most of you are familiar with the National Municipal League and with much of the constructive work that it has accomplished. It is, as you know, a non-profit organization.

The special committee which I mention is undertaking a program which it is believed will ultimately prove to be highly constructive in character and not only useful, but of material value to municipalities who wish to better their financial structure and operating efficiency.

There has been a long standing need for definitely constructive legislation that would be practical in the proper control of public expenditures, thus serving to keep the cost of local government within the bounds desired by its supporters. This phase of government has received a great deal of publicity. Each depression period emphasizes the importance which attaches and we are all very much interested in it.

State and local government officials are frequently placed in a difficult position to meet public demands in this connection. The broad subject is of vital interest to and affects all of us.

The special committee in outlining its program states:

"It consequently appears logical, instead of separately revising the various model laws, as has been done in the past, to consider the entire problem of fiscal legislation as a whole, and draft a program in which the separate parts fit smoothly together.

"Such a program should cover the four essential functions in any public finance procedure concerned with spending money raised by a tax on real property. These are: assessment of property, collection of taxes, custody of funds, and control over expenditure. In addition, it will be necessary to examine the various sources of municipal revenue and consider the soundness of state aid policies, as well as the use of state-collected-locally-shared taxes; indeed, the whole field of state-municipal relations in public finance."

The special committee also found that the effect of tax limitation laws upon municipal credit in some instances has been so serious as to wipe out much, if not all, of the benefit derived from sound budgetary procedure already established.

In this connection I would like to add that I believe an effective budgetary control act such as is contemplated would, in its practical application, provide taxpayers the opportunity to exercise control over expenditures and, through this medium, the tax levies. There would be flexibility rather than rigid limitations fixed by statute or constitution. Rigid tax limitations are strongly advocated from time to time by special interests and have usually led to unfortunate results wherever adopted, especially when made applicable to debt service.

The municipal bond fraternity, while deeply interested in the status and credit standing of municipalities, is not in itself equipped to draft legislation of the broad character required. It is, however, interested in cooperating in this

general program and in helping to promote and support it through the Investment Bankers Association of America.

In the work now being carried on through the special committee of the National Municipal League there are close working arrangements with the Municipal Finance Officers' Association, the Public Administration Clearing House, and other qualified organizations, also with municipal attorneys, Dr. Bird, of Dun & Bradstreet, Dr. Buck, who is an outstanding authority in the country on budget matters, and others.

Combined, these are the logical and best qualified people to undertake an objective of this character. We are all very grateful to these coordinating factors for the services that they will contribute as well as to those who are making contributions in other forms.

There is a related matter to which I have given a considerable amount of thought but on which I have not been able to formulate any sufficiently conclusive or constructive suggestions to place the subject before you as I would like to. It is probable that you are better equipped than I am to develop an effective approach. I would like to leave the thought with you, however, so that it may have the benefit of your study in the hope that you may be able to develop it in a constructive way.

There is a wide interest today in the economy of government and the value delivered by administrative bodies for the taxpayers' dollar that is assessed and collected. We know that some municipalities are able to render satisfactory municipal services for approximately half the cost that other comparable municipalities must pay. This is done without any apparent denial of essential services nor is it necessary in the more economically operated unit to reduce salaries or wages below reasonable limits. Recognizing that there may be a great variance of conditions applying between different municipalities, it nevertheless seems reasonable to expect that some formula can be devised which will be helpful in determining what constitutes fair costs for specific services rendered. While such a formula would be neither exact nor conclusive, it should be valuable as applied to different services in ascertaining where extravagance or unnecessary expenditures are being made and would serve as a basis for recommendations which might make possible substantial economies in local government. Such a study might go far in exploring the field even to the extent of reviewing the different types of government, such as the city manager vs. the city commission form of government, but the factual information that might be developed should prove of great value to citizens and taxpayers generally. I know of no group that is better qualified to approach this important study than your own.

THE IMPORTANCE OF PLANNING IN
MUNICIPAL ADMINISTRATION

H. L. Woolhiser
City Manager, Winnetka, Illinois

There is at least one city in the United States which has no concern with municipal planning. It is the ghost town of Virginia City, Montana, where the only municipal activity of any importance is the operation of an historical museum, glorying the vigilantes of the gold rush days of the eighteen sixties. Any superannuated municipal administrator, ready for retirement, should seek transfer to Virginia City, where he can conscientiously forget all about physical city planning, fiscal budgetary procedure and ten-year financial programs. Until then, and unless his city is unique, such matters must continue to be one of his principal responsibilities.

The sole purpose of municipal government is to furnish on a cooperative basis, those essential services for group welfare, which under the democratic process, have been assigned to it by the citizens of any community. Such governments, in our modern society, cannot remain static but rather are going concerns, continuously confronted with conflicting demands, on the one hand to provide additional and improved services and facilities and on the other, to limit or decrease the burden of taxation. To insure that these services and facilities shall be supplied economically, shall be intelligently timed as to adoption, properly balanced as to relative importance and cost, and selected with foresight in relation to the ability of the community to meet the expense burden, requires as careful and systematic planning as for any commercial enterprise. As aids to insure the accomplishment of these results, a number of practical administrative methods and controls have been developed to the point where they are readily available for effective use by municipal executives. With specific reference to organized planning, they are as follows:

- (a) Installation of an adequate system of accounting, cost-keeping and statistical records.
- (b) Development of a comprehensive physical city plan.
- (c) Formulation of a long-term financial program.
- (d) Operation under strict budgetary procedure.

The primary requisite for effective financial management is the adoption of an approved system of accounting, including facilities for cost analysis and statistical operating records, with provision for audit by an independent agency. It is only necessary to emphasize here that the accounting system should provide that all revenues and expenditures shall be strictly segregated by funds, and classified by standardized departments and functions, both as to operation and as to capital additions and replacements. This important element of accounting procedure, namely the operation of all municipal departments on the basis of a meticulous separation of both costs and revenues, is too often not observed by municipalities. At Winnetka, our municipal electric and water utilities pay a rental of \$450. per month to the corporate fund for office space in the city hall. Conversely, no free utility service is furnished to corporate departments, regular commercial rates being charged. As a result of this policy, of which the

foregoing is an example, our accounting records present a true picture of actual operating results, and provide the essential tools for financial planning. Only on the basis of an accurate knowledge of past experience can a future financial program readily be constructed.

In order that all of the facts made available by adequate accounting and statistical operations may be readily used for planning, at Winnetka we have established and keep up to date, comparative records extending back to 1923, showing for each fiscal period population, number of utility consumers, assessed valuation, tax levies, tax rates and tax revenues, other corporate revenues, operating expenditures by departments, cost for debt service and capital improvements, per capita costs for police, fire, health and other municipal services, unit cost per kilowatt-hour and per thousand gallons for electric and water service and total cost of government per capita in comparison with all United States cities. This record also shows for each year, bonded indebtedness, bonding power based on assessed valuation, book value of corporate and utility properties and current surpluses in all funds, including utility depreciation funds.

Proper provision having been made for the recording of past and present operating experience, the next essential requirement for effective financial management is the development and adoption of a comprehensive physical city plan, based on a thorough study of the city's present and future needs. Such a plan is designed to serve as a guide for the orderly development of the community as it may be expected to change in area, population and character over a period of at least twenty-five years. In its broader sense, such a plan does not relate alone to physical improvements, such as streets and public buildings; it also takes account of the present and probable future reasonable requirements of the community for all of the numerous services of government, such as police, fire and health protection, utility services and recreation. The nature and importance of such planning have become too well established to require extended comment here, except to point out that too many city plans have been developed with the "city beautiful" as their sole objective and without a realistic consideration of the possibility of fulfillment within the financial resources of the community.

Winnetka, a residential suburb of Chicago with a population of 13,000, has been operating under a city plan since 1920, and this plan has constituted an important basis for all of our financial planning since that date. This plan outlined future population and area development, existing and probable future intensity of the use of land areas as affected by zoning, the nature of future transportation requirements, both as to highway and railroad facilities, and the probable requirements for parks, schools, playgrounds and public buildings. The plan has been supplemented by studies of police, fire, health and other service activities of corporate government, as well as studies of the growth of our municipally-owned water and electric utilities, to insure that plants and distribution systems shall be adequate to meet estimated future needs, and that each capital addition will economically fit into a well coordinated ultimate design.

A foundation having been laid with respect to a physical plan and with adequate accounting and statistical records, the next step in effective planning is the formulation of a long-range financial program, taking into account anticipated sources of revenue and a carefully planned program of expenditures for service operation and capital improvements. Since 1923, Winnetka has operated under such a financial program, planned for five years in advance and revised annually to include the ensuing five years. The steps followed in the formulation of such a program may be briefly reviewed as follows:

- (a) Based on the anticipated population for each year during the five-year period, as indicated by the city plan, together with records of building construction and changes in land values, an estimated assessed valuation is set up for each year.
- (b) Such assessed valuation figures are used to compute available general bonding power; as well as probable general tax revenue.
- (c) The next step is to determine maximum limits for general tax rates for each year, as a measure of the ability of property owners to carry a share of the burden of municipal service and improvements.
- (d) Available revenues from general taxation are then computed for each year, taking into account the levies for current and prior years, to which are applied percentages of collection based on previous experience as shown by tax delinquency curves.
- (e) General corporate revenues from other sources are then carefully estimated for each year.
- (f) On the expenditure side, consideration is next given to any probable changes in the amount and nature of service requirements for each department of government during the period and the effect of such changes on cost of operation, including the effect of proposed capital improvements on operating costs. It is believed that many cities have overlooked this important point in connection with extensive improvement programs, undertaken with Federal loans and grants.
- (g) At the same time, all proposed new improvements to be financed from corporate funds are carefully surveyed and a tentative decision is made as to whether the cost can be paid for from current revenues or whether a bond issue will be required. Public benefits to be assumed in connection with proposed special assessment improvements are also taken into account.
- (h) Having determined probable corporate revenues and expenditures, including cost of debt service, the current surplus in corporate funds can then be set up for the end of each fiscal year and necessary adjustments made, taking into account services and improvements that can be dispensed with or added, under a policy of maintaining adequate fund surpluses to avoid the necessity of borrowing between tax collection periods and to allow for unforeseen contingencies and unavoidable variations between estimates and actual experience.

- (i) A similar procedure is followed with reference to the electric and water utility departments, involving estimates of maximum demand on plant facilities for each year and annual production in kilowatt hours or water pumpage, based on increase in population and number of consumers, as well as changes in use of utility services. This is followed by careful estimates of necessary capital expenditures for added facilities and for replacements; also by estimates of probable revenue and operating costs based on anticipated production. The program also shows the probable book value of utility properties at the end of each fiscal year and the anticipated current surplus in utility operating and depreciation funds, after transfers for the cost of depreciation replacements and after the payment of a dividend of 8% on property value of the electric department to the corporate fund, the latter being necessary information in setting up the program for that fund, as heretofore discussed. The utility program also takes account of the nature of security investments held by the operating and depreciation funds and indicates in advance the approximate time when these investments may need to be put on the market in order to provide available cash for extraordinary capital requirements.
- (j) Police and fire department pension funds are analyzed to determine their actuarial requirements, and where the statutory income from special tax levies and salary contributions are found insufficient, supplementary income is provided by arranging for additional salary deductions with an equivalent contribution from corporate tax revenues.

A five-year financial program having been set up along the foregoing lines, this program is carefully reviewed and revised annually or oftener if necessary. The annual revision is made in connection with the preparation of the current corporate budget; other occasions are in case of proposed revisions in utility rates; also at times when definite estimates are available as to the cost of proposed general and utility improvements; and in case of general adjustments, such as in wages and tax rates, occasioned by unusual changes in economic conditions.

Finally, after the adoption of the financial program, it is manifestly of great importance that municipal operation for any particular year should be coordinated with that program and be carefully controlled. Therefore, sound budgetary procedure is a necessary adjunct to financial planning. The fiscal budget merely represents one segment of a long-term program, but is developed in greater detail to reflect for the current year, specific plans for proposed municipal activities, based on a carefully prepared work program. After official adoption by the legislative body, such a budget insures that resulting expenditures shall be controlled within the scope of anticipated revenues.

At Winnetka, the budget report of the city manager to the Council includes the following:

- (a) An analysis and detailed discussion of corporate revenues and expenditures for the closing fiscal period, including comparisons with the budget previously adopted for that year.
- (b) A proposed budget for the opening fiscal period, including a comparison with actual revenues and expenditures for three fiscal years immediately preceding and a detailed discussion of all items presented, including the effect of important changes in the cost of services and the cost of proposed improvements, in relation to the five-year program.
- (c) A schedule of appropriations which will be required in the official tax levy ordinance, if the proposed budget is adopted, with an analysis showing comparisons with tax levies for three previous years and the effect of the proposed levy on general tax rates.

No further comment is necessary on budgetary procedure except to state that it is established practice at Winnetka for the Council to give full publicity to the consideration of the budget and tax levy. The budget meeting is conducted as a round table discussion, and is participated in by representatives of the organized citizen groups in the community such as improvement associations, League of Women Voters and the Chamber of Commerce. It has been our experience that with the budget report and long-term program in support of it, the Council has ordinarily had little difficulty at such meetings in subordinating the pet proposals of well-meaning citizens and groups to the more important requirements of the general plan.

In order to develop and maintain a confidence on the part of citizens that the financial affairs of the city are handled on a business and non-political basis, a semi-annual audit and report is made by a firm of outside certified public accountants; and the Village publishes annually in installments in the local press, a comprehensive but not too technically phrased annual report, reprints of which are made available in booklet form to all interested citizens.

As proof that systematic financial planning pays, it may be cited that in the past fifteen years Winnetka has provided general public improvements to the value of \$696,390 and utility improvements valued at \$1,585,339; and at the same time has reduced its bonded debt from a maximum of \$136,000 in 1927 to only \$12,000 at present. In comparison, the present bonding power is \$450,000. Not a single dollar of alphabetical money has been requested or received in connection with the foregoing improvements. Winnetka has never issued a tax anticipation warrant, even when general tax delinquencies were running as high as 40%, and has paid all general and special assessment bond obligations in full at maturity with interest. All municipal services have been maintained without curtailment during the depression, and some new services have been added.

The cost of municipal government in Winnetka for 1936-37 was \$19.93 per capita as compared with \$32.01 for all United States cities, and the comparison is still favorable after allowing for the fact that our municipal budget has not had to carry the large expenditures for unemployment relief which have been thrown on many other cities in recent years. Partially as a result of a dividend of

nearly \$100,000 a year paid into the corporate fund by the electric utility under rates substantially the same as those in effect in the surrounding suburban area, the general tax rate for Winnetka municipal government for several years has been the lowest of any city in Illinois between 10,000 and 25,000 population.

The sole purpose in citing this record is to illustrate the value and importance, even to a small municipality, of taking full advantage of the administrative tools available in the form of modern accounting and statistical practice, physical and financial planning and sound budgetary procedure, in carrying on the ever increasingly complex function of local government.

MUNICIPAL COST ACCOUNTING-
ITS NEED AND POSSIBILITIES

Albert E. Neale
Chairman, Municipal Accounting Committee
National Association of Cost Accountants
and
City Auditor, Springfield, Mass.

May I say right at the start that I believe that cost accounting systems for municipalities and other governmental units are urgently needed and must be developed and put into operation if internal management (and by internal management I mean the administrative officers) is to promote economy and obtain a high degree of efficiency in governmental operations. I hope that my remarks will demonstrate that cost accounting has possibilities.

The technique of cost accounting in a commercial or industrial business has been constantly developed and improved over the past three decades. There has been a reason for this--competition forced this development and industrial leaders were quick to recognize the necessity for adequate and highly developed cost accounting systems as the only means to get actual facts about their cost of manufacture and distribution. You are all familiar with this development. You are all familiar with the basic principles of cost accounting in industry. I am strongly of the opinion that these principles of cost accounting as we know them in industry can and must be applied to the development of cost systems for governmental units--not for the same reason that they are applied to private business, namely, to obtain accurate costs as an aid to internal management in meeting competition--but for the very important reason that our citizens who are paying for governmental costs, through taxes and other charges, are entitled to the services rendered by government at the lowest possible cost. Although government is not operated for profit, it is operated for service and the service rendered cannot be at the lowest possible cost without knowledge of the facts which can only be obtained through the use of cost accounting systems.

Municipalities have been constantly increasing their services to the public in accordance with the requests of the taxpayer. This increased service of necessity caused a higher cost of municipal operation. In addition to the cost of increased services we have had to deal with the increasing cost of Welfare. This situation, therefore, requires that those agencies responsible for the conduct of municipal business make every dollar count. The subject of governmental costs is of greater interest to the average citizen today than at any period in our national history. He feels a keen interest because he is paying the cost. The best way to insure that the taxpayers' money shall be wisely expended is by well-planned municipal financing and the installation and operation of adequate general accounting, auditing and cost accounting methods.

The operation of the city's financial system, or in fact, any governmental financial system, is one of the most important tasks that confronts the administrative officers -- the internal management. If the financial system is to be properly operated, it is essential that a modern system of accounting, auditing and reporting be employed. The information furnished by such a system

is of the most valuable aid not only to the financial officers, but to all the administrative officers in conducting the work of their departments in an economical and efficient manner. To obtain all the information required the general municipal accounting system must include cost accounting.

The financial operation of any municipality, large or small, should be carried on according to plans and principles. We have considered it necessary to hire trained engineers to make careful, detailed specifications of our sewers, streets and public buildings, but few of us have given thought to "detailed specifications" for the financial affairs of our municipalities. There is the same need for adherence to principles in financial planning as there is for the use of recognized standards in the fields of engineering, law and health, and these standards, to be of real value to administrative officers, must include cost accounting.

Now, when we speak of Municipal Cost Accounting, we may just as well drop the word "Municipal"--cost accounting is cost accounting whether in government or industry. The principles involved in municipal cost accounting are essentially the same as those involved in industrial cost accounting. Let us start with a definition: Cost accounting is that method of accounting which provides for the searching out and recording of all the elements of costs incurred to attain a purpose, to carry on an activity, or operation, or to complete a unit of work or specific job.

For what purpose can it be used? Broadly speaking, it can be used to provide administrative officials with a thorough control over their activities --a control which will promote efficiency and economy. It provides for a municipality, as it does for industry, a systematic method for compiling and analyzing work done and its cost; a guide in preparing the budget (and may I remind you that industry is now developing budget procedure), and in general a control over expenditures.

Before I discuss the definite uses to which cost accounting can be put, I do want to remind you that the essentials of municipal cost accounting parallel those of industrial cost accounting. These essentials have been briefly but clearly set forth by the Committee on Accounting of the Municipal Finance Officers' Association in a pamphlet published by the Committee, entitled "Standard Practice in Municipal Accounting and Financial Procedure." This publication sets forth the standards which go to make up sound financial procedures and a sound accounting system. The Committee has recognized the importance of cost accounting by the inclusion of the following essentials of Municipal Cost Accounting:

- "1. It is recommended that a cost accounting system be established for all municipal activities for which it is practicable.

In determining whether the system is practicable or not the following factors must be taken into account:

- (1) Will the cost figures be useful?
- (2) Will the benefits from the operation of the system be sufficiently great to justify the cost of its operation?
- (3) Is the activity measurable in terms of unit costs? Some activities cannot be measured in terms of work units.

An example is the activity of the chief executive. On the other hand, refuse collection is readily susceptible to unit cost measurement, the unit being the "ton of refuse collected."

"2. A cost accounting system must be so devised as to insure that all elements entering into the cost of a commodity or service are taken into consideration. These elements include labor, materials and supplies, use of plant and equipment including depreciation and overhead.

"3. In cost accounting a distinction must be made between direct and indirect costs.

Direct costs are those which are incurred directly for and are chargeable to a particular unit of product or service; indirect costs are those which are incurred for several kinds of products or services and cannot be identified directly with any particular one.

The cost accounting system must provide for allocating all costs chargeable to a particular product or service directly to such product or service and for the allocation of indirect costs on some arbitrary basis as overhead. The basis employed should be such as to insure that each unit is charged with a proportionate share of the indirect cost.

"4. Cost figures should as far as practicable be expressed in terms of units of service or product.

"5. Unit cost should be compared with unit cost standards.

A unit cost standard for municipal operations may be defined as the 'minimum average unit cost at which public works officials find they should perform their work, i.e., the minimum cost for a cleaning mile of machine sweeping, or flushing, the cost for repairing a square yard of granite block street, the cost per ton of garbage removed or incinerated.'

In comparing actual costs with unit cost standards care must be exercised to see that identical elements of cost are included in each case.

"6. Whether maintained by the chief financial officer or some operating department, the cost accounting system must be tied in with the general records.

Accounts should be established in the General Ledger to control the cost accounting records.

The totals on summary cost sheets must agree with the appropriate expenditure accounts on the books of the chief financial officer.

"7. Care must be exercised to see that there is as little duplication between the cost records and the general accounting records as possible.

"8. Officials in charge of cost records should prepare weekly, monthly, and annual cost statements showing work done, total costs,

unit costs, units per man hours, and per equipment hours, and other analysis for each operation and job. Such statements should be submitted to the proper department heads, the chief executive, and chief financial officer.

- "9. It is recommended that cost accounts be supervised and audited by the chief accounting officer. He should make certain that such accounts are accurate, that no account has been overburdened at the expense of another, and that transactions between stores and equipment accounts have been properly recorded."

A word about procedure - the Committee pamphlet states that:

- "1. The first step in setting up a cost system is to decide for which operations or jobs unit costs are to be obtained.
- "2. The next step is to adopt a standard work unit for measuring the amount of work done on each operation or job, e.g., tons of refuse collected, miles of streets cleaned, number of patient days, etc.
- "3. The installation of field reports which show the amount of labor, material, and equipment going into each operation or job follows.
- "4. It is essential to keep a Work and Cost Ledger which is posted at least once each month with the labor, material, equipment, overhead expense, and work units for each operation or job. Thus this ledger furnishes the total costs, the units of work done, and the unit cost for each operation or job.
- "5. An Individual Equipment Record should be installed for the purpose of determining the cost of operation, maintenance, depreciation, and overhead of each piece of equipment. The jobs on which equipment is employed should be charged with the use of such equipment at an hourly or mileage rate based on actual costs.
- "6. Cost reports must be prepared."

and may I add -- cost reports, to be of value to internal management, must be used.

It seems to me that just the reading of these essentials may well make you realize the need of cost accounting and at the same time demonstrate its advantages and possibilities as an aid to internal management.

The development of cost accounting for municipalities is essential to informed discussion of the cost of government. Many people now talk about the cost of government on the basis of tax rates. Tax rate comparisons in one city from one year to another may mean nothing because the assessed valuations may have been increased or decreased. Furthermore, comparisons between cities mean little since we do not always know the ratio of real to assessed valuations, nor the activities being performed in each city through money raised by taxation. What we need to do is to find out the primary activities of government which are

subject to cost finding. We want to know our own costs and to know them means that we must have adequate cost accounting. The need is urgent and the possibilities are limited only to the trained personnel necessary for its development and operation.

Now, where can cost accounting be used in our municipal set up? It can be used for practically all major operations of municipal government; public works, utilities, education, welfare, health, police, fire, recreation, and others for which a work unit can be established.

In the brief time at my disposal today I cannot hope to go into details regarding the use of cost accounting for all of these municipal operations; nor can I outline detailed accounting procedure; however, I do want to mention some of the functions in a public works department which can be subjected to cost accounting:

- Street Cleaning
- Snow Removal
- Ashes and Refuse Collection
- Garbage Collection
- Construction work--highways, sewers, sidewalks and curbing
- Maintenance work--highways, sewers, sidewalks and curbing
- Installation and maintenance of street signs, traffic signals, traffic lines, fences, etc.
- Cleaning of sewers and catch basins
- Operation of incinerator plant
- Operation of asphalt plant
- Operation of municipal garage

This might be considered to be only a partial list. The inclusion of other items would depend on the functions performed by various local public works departments.

Public Administration Service of Chicago reviewed the operations of our Public Works Department in Springfield several years ago. I think a brief excerpt from their report regarding a work program and the use of unit cost standards and standard units of measurement will be of interest to you.

"A public works department should have a work program. This program should include a well defined schedule forecasting the service or kind and amount of work to be done; the method of performing such work, and the estimated cost. Briefly, the preparation and execution of such a work program requires the following steps:

- "(1) Forecasting the amount of work to be done for each public works activity and operation showing when it is to be done and the methods to be employed.
- "(2) Establishing an estimated total cost and also a 'unit cost standard' for each of the public works activities and operations.
- "(3) Consolidating the detailed forecasts of work and costs into a comprehensive work program which will show for each activity and operation by month the amount of work to be done, the unit cost standard and the total cost.

"(4) Executing the work program during the year, which requires the use of the cost accounting machinery to tell if actual work and costs compare favorably or unfavorably with the work program estimates and standards."

"If measures of work done are to be reliable, they must be expressed in terms of standard units. Public Administration Service through research and experimentation has developed such units for nation-wide use; as for instance, in street cleaning, the 'cleaning mile' signifies a lineal mile of streets cleaned once either by machine flushing, machine sweeping, broom gang or beat patrol. Each cleaning method is measured separately, even though one method may supplement another. This does not mean that each method accomplishes the same results, only that a mile of streets has been covered. Thus the cleaning work or the cost per cleaning mile of one method cannot be compared with another directly without considering the totally different type of work done under each method.

"The 'ton' unit is used in measuring the amount of garbage collected. Separate operation cost accounts are set up for collection, supplementary hauling, set out and set back, and for disposal by incineration, hog feeding, or dumping. In some cases it is possible also to employ ton-mile costs of refuse collection. This is especially true in the case of supplementary hauling from loading stations to the point of disposal. Similar standard units of measurement are needed for all public works operations.

"A unit cost standard for municipal operations may be defined as the 'minimum average unit cost at which public works officials find they should perform a unit of their work, i.e., the minimum cost of cleaning a mile of streets by machine sweeping or machine flushing, the cost of repairing a square yard of asphalt street, the cost per ton for garbage collection and disposal, etc.' By comparing the current actual unit costs with these standards, officials know at any time whether or not their goal is being attained. The variances between the unit cost standards and the actual costs become the danger signals for the operating officials. Thus they accomplish somewhat the same results as standard costs do in industry. These unit cost standards form a definite part of the municipal work program. Just as the number of work units in the work program tells how much work or service is going to be provided during the coming year, unit cost standards show just what the cost should be during the year.

"Obviously, the present and past unit costs will form a basis for establishing the unit cost standards for the future, just as the forecasts of work will rely upon the current and past years' programs. But the mere basing of cost standards upon past years' costs is not enough. There must be a thorough study of the amount of work planned for the coming year, of changes in wage rates, commodity price levels, the cost of operating equipment, or any change in the service which may affect the actual costs of doing work.

"Unit cost standards for municipal work are purely local in their application and are different from standards furnished by other cities on account of differences in city conditions, methods of doing work, wage rates, and the like. For example, the unit cost standard for

collecting a ton of garbage in one city is \$3.50; in another it might be \$4. In one city the length of haul to the point of disposal may be six miles, whereas, in the other it may be only three miles. Raising such factors makes it easy to visualize why the same exact unit cost standard cannot be used by more than one city.

"In municipal work it is believed that the man-hour and equipment-hour figures have more value for some types of work than unit cost figures. They can be calculated accurately on a daily or weekly basis which is not so easily done in the case of actual unit costs. The fact that labor and equipment expense generally represents from 70 to 85% of the total costs of many municipal activities emphasizes the importance of these hourly standards. Once adequate cost records are installed these production standards can be calculated as readily as the unit cost standards."

The operation of a good cost accounting system for a public works department requires numerous field reports, monthly summaries, work and cost ledger, and, of course, work and cost statements. The system which Public Administration Service recommended for our use includes the following:

1. Field Labor Reports, showing the hours men work on each public works operation; in other words, the kind of work. These reports are used in the preparation of payrolls and are carried forward to the Monthly Summary of Labor, which shows hours and costs entering into each operation.
2. Daily Report of Equipment Use and Work Done, showing the hours each piece of equipment works on each operation. These reports are posted to individual equipment records to show equipment costs, as well as being carried forward to Monthly Summary of Equipment Rentals, showing hours of use and amount to be charged to each operation.
3. Reports of Work Done, showing cubic or square yards, tons, or other measurements of operation. These are carried forward to the Monthly Summary of Work Done, showing units of work accomplished under each operation.
4. Material Reports, showing quantity and price of materials used on each operation. These reports are used as credits to Stores Accounts which control the use of materials and supplies, and are carried forward to the Monthly Summary of Materials Used, showing quantity and cost entering into each operation.
5. Invoices and Payrolls, covering supervision, heat, light, telephone, and other overhead expense, which is carried forward to the Overhead Clearing Account needed to distribute overhead expense to each operation.

The four monthly summaries and the Overhead Clearing Account flow through the "Work and Cost Ledger" where a separate sheet or account is kept to assemble the cost of labor, equipment, materials and supplies, and overhead for each public

works operation and from the records of the Work and Cost Ledger come the Work and Cost Statements showing total cost, unit cost, work units, equipment hour, man hour costs, etc.

Now, let me speak for a moment about two factors that should be considered in connection with cost accounting: centralized purchasing and stores procedure. Centralized purchasing provides a method whereby all materials, supplies, and equipment used by various departments of a municipality will be purchased by one central authority. Stores procedure requires the establishment of stores ledgers and perpetual inventory systems, thus establishing the same kind of control of material that is now applied to cash. The receipt and disbursement of cash is fairly well safeguarded. The receipt and disbursement of material must have the same safeguards. The internal management of industry has long recognized the advantage of both centralized purchasing and stores procedure. Government is beginning to use these procedures. It seems to me that both are absolutely essential to good cost accounting.

Now, what progress has been made and what about the future? In the past five or six years Public Administration Service has made numerous cost accounting installations for cities scattered all over the United States. This organization has furnished manuals to many cities which desire to install modern cost accounting practices, and revise their old systems. These manuals described not only the accounts to be kept and the forms to be used in carrying out further cost accounting principles, but also provided for complete work programs to aid in supporting budget requests. Other organizations have done similar work. As to the future, many far-sighted municipal officials have already sponsored and adopted improvements in their financial and accounting procedure. They appreciate that sound organization, budgetary control, adequate accounting, including cost accounting, stores keeping, and centralized purchasing, are essential to good internal management. They realize the importance of cost accounting in making reliable comparisons between cities.

Yes, municipal cost accounting has progressed--slowly to be sure; governmental action is usually slow. Municipal cost accounting has a future; however, it is only fair to say that future progress is awaiting the further development and use of general municipal accounting and the more general recognition of the necessity, uses and possibilities of cost accounting, and here is where this organization and others of its nature can be of service in helping "to carry the torch" by advocating and working for better governmental accounting methods, including its handmaidens, cost accounting, centralized purchasing, adequate stores procedure, and one other most important factor in good administration, namely, personnel administration.

Government has many problems not existent in industry; one of the most important problems being the lack of adequate personnel administration. We can talk all we want to about better methods of municipal accounting, cost accounting, centralized purchasing, and adequate stores systems, but until we recognize the fact that good government needs good men, and therefore, that good men means good government, we are not going to progress in the development and use of good accounting methods.

Municipal accounting and finance constitute a highly specialized profession. There is a growing need for better trained men in this profession and a need for a more professional attitude on the part of those engaged in the work

of public finance and accounting. This group can render a distinct service by bringing to the attention of proper officials the need in public office today of the best persons qualified to perform municipal accounting tasks. This group should insist that men of ability be appointed for a reasonable term and that they be paid just compensation and after they have been appointed you can encourage them and assist them in their work.

My remarks have been somewhat general. What I have been trying to do is to sell you an idea; the idea that government needs and must have adequate accounting systems and that these systems must include cost accounting systems backed up by centralized purchasing, stores control, and personnel administration; the idea that cost accounting has great possibilities as an aid to internal management in effecting an efficient and economical administration and in obtaining accurate facts on which to base decisions. Why have I tried to sell you that idea? What is my reason for believing that cost accounting systems for municipalities must be developed and put into operation? Although municipal finance and the municipal accounting problems of a city are somewhat different from those of a commercial and industrial business, yet it should be borne in mind that the underlying fundamental financial and accounting principles and procedure should be complied with in accounting for the business of a city. Intelligent supervision of a public, as well as a private business, requires that facts be accurately and promptly placed before responsible officers and made available to the public whose support is essential to the successful operation of any administration. One of the factors which will guarantee the building of any city is to guarantee its financial system. That can only be accomplished by well planned municipal finance and true and accurate keeping of accounts. The question of the public's affairs should interest everyone and if a city has planned its financing properly and has maintained adequate accounting, auditing and reporting procedures, including cost accounting, centralized purchasing, stores systems, and personnel administration, that city is guaranteeing its financial system. It is providing intelligent supervision. It is getting the facts as a basis for important decisions. It is providing a control which will promote efficiency and economy. It is giving the taxpayers service at the lowest possible cost--in other words, it is conducting the city's business in a business-like way. There is my reason.

THE SURETY COMPANY'S INTEREST
IN MUNICIPAL AUDITS

Robert Steinemann
Chairman, Committee for Better Audits
Surety Association of America

In 1875 the first fidelity insurance company was organized. Today there are more than forty active companies and I feel honored to be here as the guest speaker representing those forty companies. We owe our existence and continuance to a service that an enlightened government demands--bonding of its employees and officials against malfeasance, misfeasance and non-feasance. Government, through trial and error, has learned that the service rendered by surety companies is indispensable. The Federal Government requires not only the Treasurer of the United States to be bonded, but many other officials and employees, right down the line to the charwomen in the postal service. No alleged surety association lobby was instrumental in having a lowly charwoman bonded--losses of inexplicable origin in post offices compelled the government to require surety bonds of everyone working in and around post offices. So be it with the State governments--bonds are required of the town constable as well as the state treasurer. Wherever the individual citizen or the public at large may suffer loss or injury by the acts or omissions of a public employee or official, enlightened government requires a surety bond by way of indemnity. However, surety companies are not eleemosynary institutions, and before they will expose themselves to any risk they quite properly investigate all applicants for surety bonds to an extent commensurate with the particular exposure. Therefore, it is the aim of surety companies to help provide towns, cities, counties, states, and the federal departments with honest, competent staffs of employees, managed with the same scrupulous regard for economical and efficient performance that would be expected of similar employees in private business.

With a national income of approximately \$70,000,000,000, the aggregate cost of government is estimated at approximately \$10,000,000,000 annually. There are approximately 4,000,000 employees on the payroll of the Federal Government, state governments, county governments, and the governments of cities, towns, villages, school districts, parks, drainage, levee, sewerage, irrigation and other districts--over 150,000 independent units of government. Over \$4,000,000,000 a year are paid out in Federal, state and municipal salaries--roughly representing 40% of all taxes collected. Billions of dollars are collected and disbursed annually by these public servants and officials, of whom a great many are unfitted and untrained for the heavy responsibilities of public office. In the large cities and political subdivisions of the states responsible positions are filled without regard to the past experience of the applicants--just left to the politicians to fill on the spoils basis. In the rural districts positions of responsibility are filled by boys just out of school or by unsuccessful merchants just reaching their dotage. That is the price we are paying for democracy. Without an adequate accounting and auditing system democracy is doomed. I think it was the distinguished French statesman Colbert who said: "Accountancy--that is government". I would say, a government is as good as its accountancy.

In his annual report to Congress, Richard N. Elliott, the Comptroller General and head of the accounting office, accused fiscal officials of many

Government agencies of receiving and expending hundreds of millions of dollars without proper audit and accounting. Elliott specifically accused the Electric Home and Farm Authority, the Federal Deposit Insurance Corporation, the Federal Farm Mortgage Corporation, the Federal Savings and Loan Insurance Corporation, the Home Owners Loan Corporation and the Virgin Islands Corporation of failing to comply with the "law, regulations and systems of accounts prescribed". In the report just filed, the Comptroller General stated that after many months, 4,887 items totalling \$10,727,000 made by the Tennessee Valley Authority have not been satisfactorily explained. On January 18, 1938 a loophole in the control of millions of dollars of Emergency Conservation Work funds within the Department of the Interior during the last three years or more was pointed out to the Senate Committee on Public Lands in a confidential report made by two of Secretary Harold L. Ickes' investigators. The implications in the report, written by Robert C. McCarthy and Cecil G. Miles, were made clear in the following words:

"The records in the Washington Office of the National Parks Service have not been audited in several years; neither has a proper audit of Emergency Conservation Work funds been made, either in the Washington Office of the Parks Service or its numerous field stations. It would require at this time at least six auditors the better part of a year's time to make a proper check of E.C.W. funds paid for the Department of Interior. Unless this check is made it will be impossible to ascertain the number of persons who have taken advantage of the opportunity to unjustly enrich themselves."

This statement made by Secretary Ickes' investigators came on the heels of recent revelations that a \$2,300-a-year voucher clerk in the National Parks Service had defrauded the Government of \$84,000 over a three-year period before he was apprehended. It was evidently in connection with investigating the defalcations of the clerk that the Interior Department investigators reported that millions of dollars had flowed out for C.C.C. and other conservation purposes without an audit or "proper" check-up having been made. Senator Nye stated he had reports of C.C.C. shortages of more than \$1,000,000 in the southwestern part of the United States, and of more than \$250,000 in Kansas. In the fiscal year ending June 30th last, regular and emergency expenditures by the Department of the Interior amounted to \$161,660,000.

When President Roosevelt was Governor of New York, in a special message to the New York Legislature on February 24, 1932, he said:

"I make specific request that your honorable bodies authorize a substantial addition to the number of auditors in the Department of Audit and Control. Previous Legislatures have persistently declined to give an adequate staff to the Comptroller to enable him to carry out the law under which he is required to inspect and audit the accounts of local government units--more especially those of towns and counties. At the present time he has a force so small that he is able to check up local government accounts only on the average of once in twelve years. Can any one of you say that this is an adequate carrying out of the purpose of the law? The

Controller advises me that he should have fifty more auditors. In my budget I requested ten. Irrespective of the actual number you allow, each additional auditor you authorize will serve to help the situation. You may object that additional auditors will cost the State an additional sum of money. Please think of the other side of the picture. You have heard of the recent defalcation of the Treasurer of Columbia County, whereby the bank was forced to close and large amounts of the taxpayers' moneys, intended for one purpose, were diverted to other purposes. You have heard of the defalcation of the City Treasurer of Hudson whereby \$200,000 of the public's money was stolen. You have heard of the recent indictment of the City Controller of Binghamton. You have heard of many other charges of loose financial methods and of possible dishonesty in other parts of the State. You can be very certain that additional auditors will save ten times their salaries every year in the form of safeguarding public funds. No one assumes that even a rigid carrying out of the intent of the law will wholly prevent dishonesty; but it will discourage potential dishonesty and it will do much to raise the whole standard of local government finances. This is a serious matter for the very good reason that it is your duty to make possible the carrying out of perfectly clear provisions of law that put a definite duty on the Controller. How can he carry out that duty if the Legislature does not provide him with necessary implements?"

(Incidentally, before President Roosevelt became Governor of New York, he was a vice-president of one of the surety companies I have the honor to represent here today.) Thereafter, on April 5, 1933, Controller Morris S. Tremaine told the New York Legislature in a special report that shortages aggregating \$791,345 had been discovered in the accounts of fiscal officers of thirty-one communities, including six counties, six villages and twelve towns. In some instances local officers had looted as much as one-tenth of the locality's budget. If New York City officials had looted the treasury to the same extent the theft would have amounted to about \$50,000,000.

In September, 1931 The Richmond News Leader stated:

"Rank inefficiency, insidious politics, and archaic systems of accounting, which together have infested the offices of many county treasurers in Virginia for generations costing local taxpayers hundreds of thousands of dollars, have been vigorously attacked during the past year and shortly will be rooted out of these offices. One year ago the entire State of Virginia literally gasped when an investigation by The News Leader disclosed that the taxpayers had lost \$788,000 through shortages which had occurred in the offices of ten Virginia county treasurers during the preceding three and a half years, and that twelve county treasurers were out of balance or short in their accounts at that time. The treasurers, with self-righteous indignation, fussed and fumed. The bonding companies who indemnify these treasurers demanded protection. And the taxpayers of this state howled."

In 1930 only five poorly-qualified men were available to audit the 100 county treasurers' offices. Their audits necessarily were limited in scope. The unsatisfactory character of the state's annual audits, however, was due primarily to the lack of complete and reliable bookkeeping. To check up on some treasurers was practically impossible. In at least two counties rudely scribbled memoranda sheets stuck away in the corner of a drawer were all the records that existed. To remove the causes underlying the waste and inefficiency in many county treasurers' offices, Governor Pollard appointed, in January, 1931, an outstanding young certified public accountant to fill the office of auditor of public accounts. Immediately Mr. T. Coleman Andrews went to work to determine how he might reduce the waste and loss in these offices. He visited numerous county treasurers and discussed their jobs with them. He studied the records of their offices and surveyed the manner in which they handled their work. He conferred with state officials and with surety companies. And then he developed a plan by which the operations of the one hundred county treasurers in Virginia were to be made efficient and businesslike. Within the short space of nine months Mr. Andrews installed a modern, uniform accounting system and strengthened the auditing staff attached to the office of auditor of public accounts. He insured not only that each county treasurer should be started off on the right foot, but that these offices should be regularly and thoroughly audited and the county's records kept accurately and up-to-date. May I again quote from The News Leader:

"Bringing security to the treasurers themselves, providing essential information for the county board of supervisors, making much simpler the work of the state's auditors, minimizing the waste of public tax monies, and making intelligible to the average taxpayer the county's financial condition, the new, uniform accounting system is truly, as one county treasurer has said, 'the greatest thing that has happened to Virginia county government in years'."

How well was Mr. Andrews' system working when several months later, about February, 1932, irregularities were discovered and an examination by the state auditors disclosed a shortage of approximately \$567,000 in the treasurer's office of Arlington County. The treasurer, who had served as such since 1908, was found guilty and received a sentence of two and one-half years in prison. Your organization is to be congratulated on having as one of its committeemen this selfsame T. Coleman Andrews. Would that every state in the Union were so favored! Mr. Andrews, the surety companies of America salute you!

On the morning of August 10, 1935, there appeared this news item in the Journal of Commerce:

"Birmingham, Ala. August 9 - Governor Bibb Graves of Alabama Wednesday declared that the bonding of tax collectors in the State had been turned into 'one of the worst rackets in Alabama, and I am going to stop it'. He announced that fifty of the county tax collectors who are to take office October 1st are unable to furnish bond. The law requires that they must furnish bond by September 1st, or else have the office declared vacant by the Governor and a new collector appointed. Governor Graves has arranged a conference with representatives of the bonding companies and announced that if the companies did not loosen up on their requirements the State might write the bonds."

A group of surety companies gave very careful consideration to the Governor's threat to establish a State Bonding Fund. A vice-president of one of the companies thereupon wrote:

"It is our understanding that the State of Alabama has found personal surety bonds to be inadequate for its county officials, particularly those of Tax Collectors. On the other hand, corporate surety companies have been reluctant to execute bonds for County Tax Collectors because of certain factors now existing in the laws of that State, by virtue of which losses are reported to have been sustained over a period of the last four years amounting to three millions of dollars. The economic situation which affects all states and, in fact, all nations has created situations whereby existing tax laws cannot at times be strictly carried out. Government can only function if taxes are properly collected and to collect taxes in times of stress necessitates drastic laws and enforcement. On the other hand, there is a tendency to be humane and to avoid acute distress. Under Alabama Statutes (see sections 2612 and 2613 of the Code) official bonds are required to be faithful performance bonds. Among other things, the law requires of a Tax Collector that as to delinquent, unpaid taxes he shall sell personal property and/or real estate, itself. This is not discretionary but mandatory and if a Collector fails to do those things he is liable on his bond. Surety companies are hesitant to write faithful performance bonds under such circumstances, knowing that in times of stress the Collector wishes to be lenient and either does not enforce the law, or else postpones action until it becomes financially dangerous for the principal and his surety. A Tax Collector's surety should not be placed in the position of being liable for the failure of a Collector to levy by distress and sale on personal property for delinquent taxes, nor for failure to sell real estate, if such sale and seizure, because of emergency, is inhumane and against public policy. This is a real problem for both the officials of Alabama and for the Surety Companies and both should be sympathetic toward the attitude of the other. If the proposal to create a State Bonding Fund is based in theory upon the failure of personal suretyship to protect the State against losses the creation of a Bonding Fund is not likely in itself to prevent those losses. Perhaps, the fault lies in the machinery itself. Dishonesty plays an important part in losses sustained by public bodies and must not be overlooked. We would be glad to meet the Alabama authorities more than half way. We cannot afford to execute faithful performance bonds under present conditions, but we are willing to execute bonds as a temporary measure which will guarantee that a County Tax Collector and his subordinates will honestly account and pay over all funds coming into their hands, but not to guarantee collection of delinquent taxes, nor sale of property. We propose a series of amendments, which, if adopted by the Legislature, will we

believe relieve the present unfortunate situation, although it must be understood that surety companies will only write Tax Collectors' bonds for individuals who are able to meet our underwriting standards. Necessarily the companies are only willing to write such bonds where the individual bears a very excellent reputation for honesty and business ability in his community."

Needless to say, the Governor saw the light and the following measures were put through the Legislature: (a) Uniform Accounting, (b) Auditing--employment of forty examiners with mandatory checks and balances, (c) Authorizing governing bodies of counties to appoint depositories for public funds and exempting the surety from liability for losses through depository failures, (d) Authorizing State Banks to pledge assets to protect public deposits. Today surety companies do not hesitate to write public official bonds in the State of Alabama.

In January, 1935 the state treasurer of Nebraska was finding it difficult to obtain a surety company bond in the sum of \$1,000,000 to properly qualify him for the office. During the prior term the state treasurer handled annually about \$25,000,000 in funds and about \$15,000,000 in securities. Because of substantial losses in Colorado, Kansas and Idaho, as well as in eastern states, and the contingent liability of \$56,000 on a suit then pending in the Nebraska courts against the state treasurer's predecessor in office, the surety companies were naturally not over-enthusiastic about bonding state treasurers. However, the real reasons for the surety companies' reluctance in this instance were these: the premium amounted to \$2,500 a year, fixed by law, to cover an exposure of \$40,000,000; only one of the treasurer's deputies was bonded although the treasurer and his surety were liable for the acts of scores of deputies; the treasurer was liable for loss of state money through bank failure if he had money in a bank that did not maintain continuously securities equal in value to 120 percent of its state deposit; \$15,000,000 in securities were not covered by one cent's worth of burglary insurance; and last, but not least, no provision whatever had been made for auditing the state treasurer's accounts. Because of this impasse the situation caused no end of embarrassment. Whether the State had a treasurer or not was a matter of doubt. While he occupied the office and considered himself custodian of the State's trust funds, all the normal business to the office had been suspended. Warrants for the payment of State obligations were piling up and at the same time funds were accumulating in other departments. Among the keenest sufferers from this standstill were members of the Legislature whose pay and mileage warrants had been held up. The net result was that practically every member of the State Legislature took it upon himself to foster some bill or other aimed at insurance companies until a total of 104 bills had been introduced, practically all of which were of the antagonistic type. Included was the so-called Cone Bill providing for a State Bonding Fund making it mandatory for all state and county officers to purchase their bonds from the State. In the meantime the Governor had bills drawn that were designed to meet the bonding companies' conditions and had them submitted for approval. The bonding companies delivered the bond on the Governor's promise to obtain the passage of those bills by the Legislature. In April, 1937, Legislative Bill No. 310 was passed providing for a uniform system of accounting for all county officers and "The Auditor of Public Accounts is authorized to deputize or empower not more than eight competent accountants to make the examinations and audits provided for in this article and to establish uniformity in the system of keeping accounts at salaries not to exceed Two Thousand Dollars (\$2,000) each per annum, to be paid out of such fund as the Legislature may specifically appropriate for that purpose during any biennium." Before April,

1937 two auditors were employed, and although the law called for biennial examinations the force of two had been insufficient to cover the 93 counties in Nebraska.

In the May 24, 1935 issue of The New York Times there appeared this news item:

"An audit of the office of the Cook County Clerk during the twenty-four years' tenure of Robert M. Sweitzer, now County Treasurer, disclosing a shortage of \$380,959 in his accounts and \$32,625 in interest on funds he administered, a total deficit of \$413,584, was presented to the County Board today. Immediately the Board set machinery in motion for a complete examination of the audit and Mr. Sweitzer's actions and an investigation by State Attorney William T. Tuohy. Mr. Sweitzer, one of the most popular officials in Cook County, insisted that there was no shortage and that he was prepared to turn over any money necessary to square his accounts*** The most astounding revelation of the audit report was that Mr. Sweitzer's bookkeepers had submitted to the investigators a supplementary statement in which almost the entire shortage, as verified by the audit, was admitted***The audit, hampered by missing records and the antiquated methods of bookkeeping used in the Clerk's office, is the first since the great Chicago fire in 1871. This fund represents moneys deposited by tax title buyers who failed to recover their money when the owners of the affected properties paid overdue taxes and cleared the titles to the properties. The total amount of Mr. Sweitzer's alleged diversion of funds including the interest, as traced by the audit, is \$453,202.67. But with a repayment of \$39,618.70 made by Mr. Sweitzer since Mr. Flynn (his successor) took office, the total comes down to \$413,583.97, including the missing interest."

In the January 5, 1936 issue of the New York Herald Tribune there appeared this news item:

"Suit was filed in Circuit Court today by the State's Attorney's office to collect \$533,817.92 which Robert M. Sweitzer, former Cook County Treasurer, was alleged in the suit to have withheld during twenty-four years as county clerk*** Sweitzer was acquitted by a criminal court jury of withholding public funds."

In the Readers Digest for March, 1938, is an article by Marc A. Rose entitled "Yankee Tax Revolt". Mr. Rose states in part:

"A great army of Massachusetts citizens, enlisted in a 'war on Squandermania', has recently brought about a revolution in local government***The movement, spreading through all the New England states, has achieved astounding results in Massachusetts. Lowell, to take a horrible example, had the highest real estate tax of any city in the world--\$46.40 per thousand dollars of assessed valuation--and assessments

were high. Lowell had had an old-fashioned taxpayers association, made up of 38 bankers and big property owners, but its success in dealing with the political machine was negligible. Under alert leadership the new organization has a paid membership of 3500, composed chiefly of ordinary citizens and small taxpayers. Taking the view that mere denunciation of extravagance got nowhere, the association began a searching study of municipal affairs. The facts unearthed were shocking. There was a treasury shortage of \$62,000; there were superfluous employees everywhere, many of them on the payroll without proper warrant, at a time when one out of every three homes in Lowell was either foreclosed or foreclosable; there was \$220,000 due the treasury which nobody tried seriously to collect. In short, Lowell was a typical ring-ridden American town, with some graft but with a great deal more of just plain bad government***The story of Lowell is paralleled in other Massachusetts communities among the 200 where taxpayers associations have gone into action. Needham has cut expenses from a peak of \$1,000,000 in 1931 to \$870,000, without in the least hurting public services. The Worcester Association unearthed a budget deficit of \$1,448,000. It also dug up the fact that while the city had voted back in 1922 to adopt the excellent state accounting and auditing service, the mandate never had been obeyed. Now the system is being installed and deficits in the future will be impossible***The taxpayers don't always demand that expenditures be cut. Often their committees report that more money should be spent in the interests of efficiency***At the meeting the hero is no longer the local orator, but the little man who has assembled all the plain facts about the cost and durability of standpipes***A Tax Commissioner has been appointed with money enough to hire experts and authority to examine all records and accounts*** But even more important than all the money saved so far in Massachusetts is the restoration of popular government--the revival of an informed, alert and aggressive electorate."

In an address entitled "What the County Should Expect From an Audit", delivered a short time ago to members of the Kansas County Commissioners' Association, Mr. Barton Avery, Assistant State Accountant of Kansas, stated in part:

"A copy of each audit made is filed in this office, this copy is completely checked to see that the auditor has used proper beginning balances and that he has covered the field as required by the minimum standard audit program as prepared by the State Municipal Accounting Board. The auditor is written to in regard to any items which have been omitted in order to find whether or not such items have been covered. It is exceedingly difficult at times to know whether the working papers of an auditor entirely support the items set forth as required by the municipal program. At the present time we have been calling at the offices of the various accounting firms to assure our department that the report is properly supported by adequate detail***It might be advisable at this time to give you the following figures as a compilation of items revealed in audit reports filed

during the first year of compulsory annual audits. These figures are taken from county audits and represent shortages according to offices, except in the case of county commissioners which figure represents salary overpayments--county treasurer \$7,323.79, county clerk \$5,491.42, sheriff \$6,785.65, register of deeds \$2,167.43, county attorney \$272.90, county superintendent \$989.75, clerk of the district court \$72,078.95, probate judge \$3,042.16, county commissioners \$1,485.24, justices of the peace \$3,454.05, judge of the city court \$1,519.23, totalling \$104,592.57. In most instances these items have been paid in, but in some cases they have not--this is where your responsibility rests. It is necessary in all cases for you gentlemen in conjunction with your county attorney to make these collections. There has been a general feeling in the past to not do anything about a shortage if the officer making the violation paid the shortage in. Of course, it is necessary to distinguish between errors made honestly and those representing fund misappropriations and your methods of dealing with individuals should be tempered by the intent of the individual. We stress your dealings with such offenses because generally when a misappropriation exists and the offender is not removed the situation usually becomes worse. For example in one county the officer misappropriated some nine hundred dollars and was allowed to repay it. The next time an audit was made, the officer was seventy thousand dollars short. This instance, however, represents a situation prior to the enactment of the accounting law and is not included in the above shortages. We could quote you numerous examples such as this, some situations become so complicated for the individuals that they resort to suicide--our contention is that it is much better to remove the official before such an unfortunate situation arises***It is the contention of this office that regardless of the fact that such a shortage is repaid does not excuse the officer from guilt***We have little sympathy with an auditor who intentionally covers a shortage for an officer***It is the opinion of this office that the auditors who cover such shortages are aiding and abetting the crime and are as guilty as the officer***You probably also wonder what the audit should show. The idea that prevailed for a long time that audits were merely made to reveal shortages is rapidly passing into discard in municipal audits, the same as in commercial audits. The real purpose of an audit is to make a detailed analysis of all acts which affect the administration of an office, to arrive at an officer's chargeability and also to ascertain the method in which the official shows his dischargeability***From some of the fees charged for audits made, we of this department are inclined to wonder what a county can conscientiously expect for that price? We are not inclined to blame the counties in all cases, but we do think there has been a tendency to shop for prices rather than capabilities in a number of instances. The net result being that the audit is an accumulation of figures which in most cases are meaningless to the Boards and when actually checked reveal many weaknesses***

An audit properly prepared is a valuable asset to the county because it gives an unbiased report of every function of the government, it is a gauge of past performances and can be used to a constructive advantage in adopting policies for the future. The schedules are broken to the same period as the budget and are supposed to present as many classifications. In this way, the audits can be used to base estimates for budgetary purposes. The cooperation that our office has received since the law has been in effect has been gratifying and clearly indicates that the officials are interested in giving good administration. Full cooperation is needed to secure the best results from the law. We wish to make it clear that our attitudes are not dictatorial, we hope to receive cooperation from your various boards in order to improve certain conditions for the benefit of better government in each community. Letters received by our office regarding controversial points are given careful consideration because it is by this means that we adjust our program to better fit your needs. We believe that you will find that proper adherence to these provisions will result in greater efficiencies in your offices and a greater value received for each dollar of tax money expended."

The State Auditor's Department of Missouri reported the official accounts in 49 counties revealed apparent discrepancies totalling \$572,930. Many of the counties have not been audited for years. The Code provides that annual audits shall be made of every treasurer's accounts and yet the accounts of the treasurer of Charleston City and the treasurer of Mississippi County were never audited in 18 and 20 years respectively--until the surety companies were asked to pay shortages of \$20,000 and \$58,000 respectively. At this point, I pause to criticize the certified public accountants of Missouri because they were not self-assertive. Where the law requires annual audits, local organizations of certified public accountants should see that the law requiring audits is complied with. Surety companies not only refuse to bond public officials whose past performances do not qualify them for public office but by the same token they now refuse to continue bonding money-handling officials unless their offices are regularly audited--law or no law notwithstanding. Absence of adequate audits is tantamount to criminal negligence. Surety companies would not long survive, as their loss experiences abundantly testify, unless their efforts eventuated in better personnel and better audits--one without the other is not enough. That is why the Surety Association of America joins hands with the National Civil Service Reform League and the American Institute of Accountants. The non-partisan slogan of one and all is the same: Better personnel and better audits in public offices!

Why continue citing more instances from the records? All over the country audits have been notoriously conspicuous by their universal absence. Most public officials are honest and most of them welcome guidance and cooperation but the pressure of strong political groups incessantly harasses them. An audit must be divorced from political supervision. It must be made by a disinterested third party, thereby minimizing politics and temptation. No thorough private corporation would think of submitting to its stockholders an audit made by its officers or directors--an outside certified public accountant is invariably engaged to act and report with freedom and independence. Our whole financial structure would fall otherwise. (Several weeks ago New York was startled

upon learning that the prominent stock brokerage firm of Richard Whitney & Co. had failed. Mr. Whitney was five times President of the New York Stock Exchange. In the court proceeding it was disclosed that the bookkeeping methods employed by Whitney's firm were vague and at times haphazard; there had never been a complete audit, the witness testified, since the firm was organized in 1916; there were no regular audits by an outside accountant and Whitney testified that he himself did not know when the firm first lapsed into serious financial difficulties.) Frequent and thorough audits of accounts are as necessary as periodic check-ups on one's physical and financial condition. (A stitch in time saves nine.) Surety companies are unpopular with politicians and parasites because the companies continually insist upon having copies of audits and clearances of accounts. If a surety company obligates itself by signing a bond in behalf of a public official who handles funds, it is entitled to know what disposition the official made of those funds. Though the responsibility of the official is co-extensive with his surety, yet in the final analysis the surety company most always holds the bag, because few if any public officials are sufficiently responsible financially. Because surety companies refused to be stamped into committing financial suicide they were called racketeers by prominent public officials and legislators. (There is no more honest business in the world than the surety business.) Of what stuff are these public servants made that they should bite the honest hands that feed them? In a spirit of spite, legislative bills are introduced providing for a state bonding fund--a socialistic step grounded in malice--because, as in one instance, the pay and mileage warrants of legislators were held up by the proper requirements of the surety business. I venture to say that nearly every threat of a socialistic state fund is thus founded in dishonesty or hypocrisy. It seems to be the order of the day to insult honest business, particularly if it is big business. (There is more real benevolence and paternalism in so-called big business today than was ever dreamed of by the idealists and wished for in a Utopia. How many public bodies have voluntarily provided camps, clubs, restaurants, hospitals and all kinds of insurance against illness, injury and old age for their employees? The General Electric Company paid \$2,499,893 during 1937 to 3,436 retired employees. On December 31, 1937, there were 3,214 on pension and retirement rolls, with an average annual payment of \$768. Stop and think of the millions of dollars that have been squandered by public bodies and pilfered by public officials, exclusive of the undiscovered losses! And yet when it comes to audits, showing where and how the taxpayers' money was spent, legislators have the temerity to pass negative laws reading: "The Auditor of Public Accounts is authorized to deputize not more than eight competent accountants at salaries not to exceed \$2,000 each per annum." What generosity and what magnificence--how penny wise and how pound foolish!

I think your chairman, Mr. George P. Ellis, covered the whole public official problem when, at the 50th Anniversary Celebration of the American Institute of Accountants, he stated:

"Recent embezzlement cases in public office disclosed that poor accounting and auditing had as much to do with creating the situation as had the incompetence and dishonesty of public officials. Audits which fail to find existing shortages give guilty employees a feeling of false security that leads them on to further thefts."

In closing, may I offer this toast from the surety underwriters of America to the certified public accountants of America: More audits to you--better audits for us. And may the taxpayers of America benefit by both!

OBSTACLES IN CONNECTION WITH MUNICIPAL
ACCOUNTING AND FINANCE

Deneen A. Watson
Chairman, Section on Taxation
Illinois Bar Association

With so much work to be done, it is most gratifying to see the American Institute of Accountants and other cooperating groups assume the greatly needed leadership in the field of municipal accounting and finance. I, therefore, want to congratulate the American Institute of Accountants and such leaders as George Ellis for the splendid work they are doing in this field. This type of leadership cannot fail to gain the greatly desired objectives of improving municipal accounting and finance.

Great progress has been made in many fields of endeavor, such as science, industry, etc. The field of administration of governmental affairs, generally speaking, however, is devoid of substantial improvement. This is particularly true as to the fiscal affairs of government. This anomalous situation, in the main, seems to arise from the fact that those in control of the destinies of government are fearful of the toll of progress in their field. These technocrats of government are hard to move. It has always seemed queer to me that the taxpayer, even though he was expected to pay the bill, has had little to say about anything relating to the operations of government and has had to beg his supposed servants for an accounting to find out where his money was going. The divine right of kings seems to have lost some of its force, but not the divine right of the politician. This strange complex among politicians is hard to justify and must not be allowed to continue.

There is as much, or more, reason for running government on a business-like basis, as business itself. None but the most gullible of investors would think of investing in a company where they did not know the exact status of the company. Similarly, we should not expect taxpayers to pay their taxes, unless they know what is being done with their money. I take it that it is the intent of this conference to point the way.

The topic assigned to me for discussion this afternoon is "Legal Obstacles in Connection with Municipal Accounting and Finance." Because of the fact that there are many obstacles, other than legal ones, to improving municipal accounting and financial practices, I have taken the liberty of discussing obstacles generally, rather than confining my remarks to just the legal ones. I trust that my usurpation of authority will be condoned. I hasten to add that even with this appropriation or assumption of power, I still shall not make my remarks very lengthy. I prefer to consider that my talk shall be construed as being in the nature of one coming from a leader of discussion and that we shall, as soon as I have finished it, resolve ourselves into a forum where interchange of ideas will lead to constructive action.

At the outset, so far as our discussion here is concerned, I would like to define the term "municipal" and including local governments, such as counties, towns, cities, school districts, etc., as distinguished from the state and federal governments.

There are many obstacles to be overcome before we have an ideal system of municipal accounting and finance. The chief ones, however, are:

1. Decentralization of government,
2. Statutes are inadequate, and
3. Lack of trained men and proper facilities to operate an efficient and up-to-date system.

The obstacle, designated under the heading of decentralization of government, has many ramifications and I would, therefore, like to discuss the situation somewhat at length.

There cannot be responsible local self-government where decentralization is carried to extremes. This is particularly true in Illinois where our 17,000 taxing bodies constitute one-tenth of the taxing bodies in the country, or to put it another way, a number equal to 25 other states. Our 12,000 school districts, 1500 townships, 1500 road districts, etc., means such a division of authority among local officials, and a smallness of dominion as to forestall responsibility of action to the people. How can any taxpayer possibly keep in touch with the actions of the many taxing authorities directly affecting him?

In Illinois, our situation was in the main brought about by two factors, namely, (1) early need for small areas for local government, because of a lack of communication and transportation, and (2) the provisions of the Illinois Constitution of 1870.

Few will deny the necessity for the township and, perhaps, other small units of local government fifty years ago. Their need, however, has long since passed. Many states have seen the wisdom of eliminating these many unnecessary, expensive and undesirable forms of local government. In Illinois, however, our Constitution and statutes make change very difficult. For example, under our Constitution, you cannot eliminate the township without having to take the county or commission form of government. This form of county government is considered by many to be as objectionable as the township form of county government. The framers of the Constitutions of 1848 and 1870 wanted to be sure that they perpetuated township government in Illinois and they did a very good job in this respect.

Further, under our statutes, township government also gets a break by the provisions that if a county desires to change from commission form of government to township government, the petition therefor need be signed by but fifty voters. However, if you want to change from the township to commission form, the road is much harder - in counties having a population of less than 75,000 inhabitants the petition must be signed by five per cent of the voters and if the population exceeds 75,000, then the petition must be signed by twenty per cent of the voters.

Further, decentralization is greatly increased in this State by the provisions of Article IX of our Constitution which limits tax rates and indebtedness. Section 8 of Article IX provides that county authorities cannot assess taxes in excess of 75 cents per \$100 valuation unless authorized by a vote of the people of the county. Section 12 of Article IX provides that a municipality, and this term includes all local governments, cannot become indebted to an amount aggregating more than five per cent of the value of the taxable property within the municipality. These restricting provisions have led the Legislature to create

new taxing bodies and further decentralization when these provisions prevented local authorities from doing what they and, perhaps, most of the citizens of the area affected, deemed necessary functions of government.

Some of us in Illinois believe that under present conditions, the county is the proper place in which to vest the functions of local government. We, therefore, propose to reorganize local government and reform county government in this State. It is only through such a move that we can secure a responsible local self-government.

The second obstacle to an improved municipal fiscal set-up was above noted as being the fact that statutes on such subject are inadequate.

You, no doubt, are familiar with the fact that there are about as many different types of statutes looking toward improvement in local financial practices as there are states that have enacted such laws. They vary from the hit-and-miss variety, which exists in Illinois, to the centralized state control that exists in Indiana. Wylie Kilpatrick has, perhaps, done more work in collecting information on, and comparing, such acts than any one in the country. His article and charts found in the 1936 Municipal Year Book are very illuminating and comprehensive with respect to the subject-matter and, if you are interested and have not read this and others of his articles, you will find his data and conclusions quite valuable.

In your studies of the statutes you will be impressed by the fact that most of them are still in the pioneering state and that even those whose merits have been declaimed from coast-to-coast are far from perfection. In Illinois, we have just started. I am reluctant to say so, but I think that we are the forty-eighth state in regard to improving the financial practices of local government. I hope that a recent bill which I played some part in getting enacted into law will be a forward step.

This bill known as The Illinois Municipal Budget Law provides that some 16,000 of our 17,000 taxing bodies must annually prepare, hold hearings on, and adopt budgets. The taxing bodies exempted from the provisions of the Act already had some provisions relating to budgeting. The Act also provides that the State Tax Commission shall prepare forms for the budget, collect copies thereof for compilation and comparison purposes, conduct training schools for local officials, etc. These forms are now being prepared and will be available shortly. It is a non-compulsory and educational act rather than a mandatory one. But experience in other states indicates that this is a preferable approach to a successful solution of the problem. It is hoped that from this bill will come some semblance of uniform accounting, reporting of financial statistics, budgeting, comparison of expenditures, better trained local officials and, perhaps, mandatory auditing of local governments by independent accountants. In Illinois, therefore, it can be said that we come under the category of not having adequate statutes to insure a proper set-up but that we expect ultimately to secure it.

The third and final obstacle to an ideal municipal set-up is found in the fact that there is a lack of trained men and adequate facilities to operate an efficient and up-to-date financial system. The turnover in personnel; the fact that many local officials do not know what to do to improve their

situation; the fact that many local officials do not have the time or inclination to do a good job; the fact that many of our officials do not have the background of experience necessary for a proper execution of their duties; and the lack of proper records and other necessary office equipment -- all contribute a deterring influence against a better set-up. Only through the enactment of legislation looking to civil service for employees necessary to properly conduct the affairs of these governments; to qualification for office holders; and adequate office facilities, can there be substantial progress. If many of the functions of local government were centralized in the county, adequate and qualified help and records could be obtained. Under our decentralized system, however, it would almost be impossible of attainment.

By way of summary, it is, therefore, recommended

1. That the county be made the principal unit for the performance of local functions of government and that county government in Illinois be materially improved. Only through such a centralization can local government be saved and made responsible.
2. That adequate and comprehensive statutes, looking toward local rather than state control, be enacted that will insure the highest possible type of expenditure control, through uniform accounting, auditing, reporting of financial statistics, budgeting and other proper statutes looking toward enlightenment for the taxpayer and a responsibility by his local officials.
3. That civil service and qualifications for local financial officials be made compulsory, in order that the business affairs of local government shall be conducted efficiently and properly.
4. That adequate records be kept of local financial affairs and periodic audits thereof be made by independent auditors.

By way of summary, I make the suggestion that the fine work now being done here be carried on and even intensified. As I stated in the beginning, there is much work to be done. Only through unified action - not talk - can lasting beneficial results be attained. That these things are desirable and must be done cannot be disputed. I stand ready to do my part. Do you?

THE PUBLIC'S INTEREST IN MUNICIPAL REPORTS

Douglas Sutherland
Secretary, Civic Federation and Bureau of
Public Efficiency, Chicago

Printed reports covering the activities of the local governments and made available to the public in standardized form and at regular intervals, with reasonable promptness after the close of the period covered, afford the only normal basis the people of any community have for judging whether or not their affairs are properly managed and whether or not the funds they supply are being honestly and efficiently expended. The only other means the public might have for any such determination are inquisitorial processes which are rare in occurrence and likely to be tinged by politics, or infrequent audits covering long periods of time, which are expensive and often produce results of little real value.

These remarks will deal particularly with financial reporting. It is of course desirable that a municipality, or perhaps the major departments of very large municipalities, should publish annually factual reports, in as brief volume as possible, but readable and with illustrations limited to showing the really important work accomplished or projected. Such reports have value, particularly if the accomplishments and activities of the year covered are presented in actual comparison with those of the year or period of years preceding. Unfortunately, abuse of the factual report is rather easy and it is not unknown to find it serving chiefly to advertise the political heads of the government involved and as the occasion for fat printing and engraving contracts. As a rule this latter type of factual report is never accompanied by any fiscal report, or at least with none of much value, either published independently or as part of the factual report. In any event the most excellent report of physical or administrative accomplishment does not give the interested citizen a very satisfactory or complete picture of his local government unless, covering the same period, he is given also a full and complete report by the chief fiscal officer on the operations of the various funds of the municipality which have made possible its achievements and administrative activities. As has been urged by the National Committee on Municipal Accounting, the annual report of the comptroller or chief fiscal officer, in order to have real value, should be published not later than three months following the close of the period which it covers. In no event should the financial report be held back in order to include it in the administrative report, which may take longer in preparation. Also both the financial and the administrative reports will receive more public attention if they are separately published. The administrative report may well refer to and include key parts of, the fiscal report, but very definitely there should be a separate and complete public accounting by the fiscal officer. However, if the public had to choose between even the best and least overdone report of physical and administrative accomplishment, and a thorough-going financial report, it should by all means insist upon the financial report, as having (except perhaps in a very few cases) much the greater practical value.

Why should one make such a statement? If a hundred visitors to a library were to pick up both kinds of these reports, perhaps fifty would at least sketch through the factual report and perhaps five would really read it, while probably not ten of them would open the financial report and perhaps not one of

the ten, unless he had come to the library for that purpose, would really look through it. This thought undoubtedly is in the minds of many of our public administrators and may be one of the reasons why many financial officers do not publish adequate annual reports or do not get them out in time to be of much if any value, or fail on both of these counts. The other day I was pleading with the head of a certain local government to let his comptroller put out a separate financial report in really adequate form. I regard this gentleman as one of the best public administrators I have known. The affairs of his municipal corporation are in excellent condition. All of its funds have been thoroughly audited by highly reputable C.P.A.'s. It has good financial controls. Yet, its annual financial reports are to a great extent lacking in the essential material one looks for in trying to get a correct idea of the situation of a government. This official was anxious to cooperate (and I am sure that in the future the reports of his fiscal division will leave little or nothing to be desired) but when I responded to his request for the details which such a report should present, his reaction was:

"Why go to the expense of printing such a mass of statistics which nobody will read? No one is interested in that information except your association and a few other students of government and the financiers who are interested in our bonds and warrants, and you fellows have access to our books and records at all times."

And that is true, in the case of that government and also of the other major Chicago governments, at the present time. It has not always been true in the past. It might not always be true in the future. And, if it were always to be true, what of it?

The answer to this contention is plain. There must be an official published record of the essential facts which are set down in the financial accounts of each government - for each fund a balance sheet, a surplus statement, a statement of income and expense, a statement of receipts and disbursements, and such supporting schedules and statistical information as will explain the situation to those who are interested. Expenditures particularly should be reported by funds, divisions and purposes so as to compare with these items in the appropriation ordinance and also with similar expenditures for at least the immediately prior year. Citizens John Smith and Mary Jones after office hours may respectively prefer a detective story and a movie to reading such a report, even if it is about their money, and the tired C.P.A. may decide not to emulate the postman on his fabled vacation. Nevertheless, when budget time comes around, or when the government is asking for more taxing authority, a lot of people will be asking questions, and the answers cannot be given without the information which should be contained year after year in the comptroller's report.

If such reports are not at least made available to the public for use as needed, or if from year to year their character and form of presentation is so varied that it is difficult to compare one year's operations with those of another, and they, therefore, become valueless, the affairs of that government ultimately are likely to get into a tangle that will be expensive for the public and probably embarrassing to the officials.

On the other hand, good habits of consistent financial reporting will help to keep governing agencies and their administrators out of financial difficulties and embarrassments. If accounts are well kept and good financial controls maintained, the cost of getting out adequate annual reports need not be prohibitive.

Expensive printing and very wide distribution need not be resorted to. Enough copies for the press, the local libraries, universities and colleges, fiscal officers of other governments, civic research agencies and the like, should give sufficient coverage. The comptroller's reports for Cook County for 1936 and 1937 which have elicited much favorable comment, are very inexpensively reproduced. Public executives of these days who desire to demonstrate a sense of financial responsibility in governmental affairs, as I believe is true of our local officials, can render no more enduring service than that of establishing a precedent for sound and satisfactory fiscal reporting.

A PROGRAM OF MUNICIPAL REVENUES AND
EXPENDITURES TO MEET CHANGING SOCIAL,
ECONOMIC AND POLITICAL CONDITIONS⁽¹⁾

James W. Martin
Commissioner of Revenue
State of Kentucky

In order to deal with the subject matter which has been assigned me I shall assume that I am to discuss expenditures merely as a means of providing a background for the discussion of municipal revenue developments. To this end I remind you simply of certain outstanding facts with respect to municipal expenditures and expenditure policy which condition, or perhaps actually determine, the revenue necessities of city governments.

The most arresting fact one confronts on examination of the services of municipal government is the remarkable increase in the activities of the cities over a period of years. The people of the United States are not only living more largely than before in the cities, but they are demanding extensive increases in the activities of their local governments. These increases take in general two forms. In the first place, there is a progressive addition to the normal functions of city government, which indicates the employment of the municipality as a purchasing agent for its citizens on a larger and larger scale.

In the second place, and seemingly as a purely depression phenomenon, there is a marked increase in those functions which in the Bureau of the Census classification are included under the general heading "Charities, Hospitals, and Corrections." In the past ten years the proportion of the total expenditures of city government utilized for such purposes has gone from slightly more than 6 per cent to almost 20 per cent of the aggregate municipal expenditures. Although a decline in the proportion of total expenditures devoted to charities, hospitals, and corrections may reasonably be anticipated if the general economic situation is greatly improved, nevertheless the total amount which cities will devote to such purposes will almost certainly be greater by a substantial margin in the future than in the past.

The past quarter of a century has witnessed a remarkable alteration in the general complexion of municipal government throughout the United States. It may be said without exaggeration that during the first decade of this century almost no great cities had devised and utilized in a substantial measure modern administrative technique. For example, the accounting and budgeting procedures were either entirely lacking in the modern sense of the word or were so embryonic as not to reveal to the people such facts about the finances of local government as to render critical appraisal possible. In point of fact, the municipal administrations in most cities at that time did not deserve the confidence of the people. Today the situation is materially changed. Although there are still too many inefficient, and perhaps even corrupt, municipal officials and employees, the general tone of city government throughout the country has been revolutionized. It may be said with confidence that the greatest progress found in government anywhere during the past quarter of a century is that which has occurred in the field of municipal government in the United States.

In view of these developments and in view of the increasing confidence reposed by the general public in local government, it may reasonably be expected that cities will continue to be an increasingly significant quantity in our economy. As an incident, it is reasonable to anticipate, despite offsetting considerations to be noted, that municipal expenditures will continue to exhibit an upward secular trend. Under these circumstances, careful inquiry into the sources of city revenues is of tremendous importance.

Municipal Revenue from Local Sources

Prior to the last decade revenues for the operation of municipal government were derived from property tax levies to the extent of approximately 83.4 per cent. Although the amount of revenue from property taxes has increased, that proportion has been reduced somewhat, until today in a typical sample of seventeen large cities about 75 per cent of the total revenue for urban local government comes directly from property tax levies.⁽²⁾

Looking at the situation from the point of view of local taxes only, the proportion of total city taxes derived from property taxation has declined from about 94 per cent ten years ago to about 93 per cent at the present time. As a matter of fact, however, the proportion of property taxes varies greatly among the large cities of the United States.⁽³⁾

Examination of the facts in respect of eighteen large cities indicates that the rate per thousand dollars of actual value of real estate ranges from \$14.07 in the District of Columbia to more than four times as much in Jersey City. The effective tax rates applicable to different classes of property seem to vary in extreme cases to a remarkable extent. In Jersey City, for example, the effective tax rate appears to vary from \$36.69 on stores to \$60.95 on single family dwellings. Were individual property assessments known, the variation disclosed would doubtless be simply prodigious. Attention should be directed in this connection, however, to the fact that a number of cities have reduced the variations between different classes of property to a comparatively small quantity. In Cincinnati, for example, as among stores, multi-family dwellings, single floor houses, two-family dwellings, and other single family dwellings the maximum variation was from \$13.29 on single-floor houses to \$15.92 on multi-family dwellings; and in Baltimore the maximum variation was from \$21.71 on two-family dwellings to \$23.53 on multi-family dwellings.

Viewing the situation from another angle, the figures for the same eighteen cities indicate that the volume of property taxes imposed on a typical \$7,000 home varies from a low point of \$73.08 in the District of Columbia to a high of over five times as much in Jersey City. The maximum difference in taxes on other sorts of real estate seems to be about the same among the several cities, except that the variations in the taxes on business property are less than those on dwellings.⁽⁴⁾

It is apparent then that one of the most urgent municipal revenue problems is that of improving property tax administration. Of course, the most important phase of this is real estate tax assessment and collection.

A number of forces have recently been operating to improve the caliber of property tax assessments. It is urgent for municipal government in general, and municipal finance in particular, that these and other factors continue to aid in

effecting better administration of assessments. By far the most important of the several influences at work, outside of assessment offices themselves, is the National Association of Assessing Officers which assists in the development of better assessment practices. In the first place, the Association through its annual conferences and publications assembles and publicizes information respecting the best practices, so that as improvements are effected in one part of the country opportunity is afforded for their utilization elsewhere. In the second place, the Association aids in local assessment practice by making available the results of careful study conducted by its staff under the supervision of committees representing the best assessment personnel throughout the country. In the third place, it serves as a clearing house of interchange of information through inquiries and other correspondence.

A number of municipal leagues have contributed locally in somewhat the same manner.

Another aid which has been available and which has materially improved assessments is the utilization in a number of parts of the country of WPA workers as a means of accumulating assessment data. Among the outstanding projects of this sort are those conducted by the Oklahoma Tax Commission, the Wisconsin Tax Commission, several cities in Michigan, and King County, Washington.

Numerous methods of promoting good assessments and promoting public interest in assessment practice have been invoked. In some communities conferences have been held with assessors, or with assessors and representative private citizens; in others the radio has been employed as a means of publicizing the facts about assessments; and in still others public information through the press and through pamphlets has been circulated widely.

A few new sources of assessment data have been developing in recent years. Possibly the most significant of these is information with respect to data made available in income tax returns which it has been possible to utilize since 1935 as a result of the so-called Costigan Amendment to the Federal Income Tax Act. Another significant source is more extensive use of maps made possible as a result of aerial surveys.

Although the necessity for improved administration of property tax collections is as serious as the need for better assessment administration, achievements have not been as great. As a matter of fact, during the extreme depression years 1932-34 inclusive, collection machinery in a number of communities practically collapsed. Valuable repair work has been done, and more may be anticipated. Through careful studies, such agencies as the National Tax Association, the National Municipal League, the Municipal Finance Officers' Association, and the International City Managers' Association have rendered available information which makes possible much better tax collection. Nevertheless, in many cities throughout the United States antiquated and ineffective collection procedures still obtain. In some instances, these practices exist because of unfortunate state policy imbedded in permanent legislation or even in constitutions. In others they exist as a result of local inertia. In the light of current and prospective economic and political conditions, however, tax collection may reasonably be expected to improve--perhaps at an accelerated rate despite the difficulty which the public seems to experience in understanding that improper collection practices and consequent nonpayment of property taxes eventuate in discrimination as grave as that introduced by poor assessments.

One of the suggested improvements in property taxation is the readjustment of local levies. As has been shown already, there is generous room for added property tax levies in about half the large cities if one may take as a criterion of feasibility experience in the other half. However, in the case of several such cities the state property tax limitation statutes preclude further utilization of property levies. This situation is particularly apparent in Ohio cities. On the other hand, examination of the facts leads emphatically to the conclusion that property tax levies are extremely high--perhaps impossibly high--in certain cities.

In many parts of the country cities have undertaken to derive substantial revenues from miscellaneous sources, and to some extent the effort has been successful. Among the revenue measures adopted by the municipalities in various states are gasoline taxes, especially in Alabama and Missouri, and general sales taxes, particularly in New York City. Throughout the United States municipalities have utilized alcoholic beverage licenses as one comparatively small but important source of revenue. Licenses of other sorts have become an increasingly important source of municipal income, though again the aggregate is less than 5 per cent of all municipal receipts.

In some of the cities situated in states where over-all property tax limitations have been applied, the use of service charges and special assessments has greatly increased. For example, whereas sewage service is provided at general taxpayer expense in most cities of the country, Ohio cities largely finance sewage disposal through charges imposed on users of the service. Viewed as a whole, however, the aggregate revenues from such sources constitute a smaller proportion of total revenue receipts than they did a decade ago.

In the light of general political policy, based on existing and prospective economic and social conditions, one may reasonably expect a continued improvement in property tax administration--an improvement which should be the source of most of the additions to revenue made available locally; whereas, certain types of service charges and public utility earnings may be reasonably expected to increase for municipalities generally. Miscellaneous revenues will probably continue to constitute a relatively insignificant item in most city budgets.

Receipts from State-administered Taxes

In the recent past a number of states have extended the practice of imposing taxes, the receipts from which have been shared with municipalities and sometimes with other local units of government. The practice arises from the fact that many sorts of taxes can be administered more or less effectively by the state but cannot be well administered by municipalities or other local units of government. Almost every type of state tax has been imposed in some place or other with a view to making some or all of the revenue available for local purposes. Among the taxes thus employed are gasoline taxes, income taxes, general sales taxes, tobacco taxes, alcoholic beverage taxes, and others.

An objection to this practice is the local attitude toward subventions generally and not merely toward state-administered taxes for local use. That is, localities receiving revenues which they do not themselves impose are prone to view this part of the public income as "easy money". In some instances this difficulty leads to wasteful expenditures of state-imposed taxes, even though local receipts are much more carefully safeguarded.

Another limitation on the use of state-administered taxes for local use arises from rapid centralization in many states combined with the retirement of state governments from the large use of property levies as a primary source of revenue. But for the current increase in use of relatively new sources of state revenue sharing of state-imposed taxes could not go on as rapidly as it has done and promises to continue doing.

Notwithstanding the objections, there has been some increase in municipal income from this source, and it may reasonably be expected that this increase will continue. It is improbable, however, that in the near future state-imposed taxes will become so important a source of municipal revenue that they will serve to reduce materially the property levies. Indeed, despite the recent growth in such revenues, the total is almost insignificant compared with receipts from real estate.

The extent to which sound public policy is served by increasing municipal income derived from state-imposed, locally-shared taxes depends largely on the possibility of devising techniques by which the tendency to regard such revenues lightly can be applied. Possibly after a period of use and with the cooperation of municipal leagues and other similar agencies, the treatment of such revenues as gifts from the gods can be reduced. The employment of this revenue mechanism is not only more extensive but more effective in relatively rich states. In the poorer states economic conditions may dictate very limited use of this revenue device, and the assignment merely of the great bulk of property tax revenues to local rather than to state purposes.⁽⁵⁾

Receipts from Grants-in-Aid

Cities receive grants in aid of particular expenditures or expenditure classes from both the state and the federal governments. The former are in many states a matter of long-range policy; the latter appear to be rapidly becoming a fixture in our fiscal practice. However, there are still elements of uncertainty in respect of federal grants to local government.

The data respecting the volume of subventions are not very satisfactory except on a city-by-city basis, mainly because the Bureau of the Census combines subventions from federal and state governments. It may be said with assurance, however, on the basis of figures at hand that state grants-in-aid have approximately trebled in the past ten years and that federal grants-in-aid have risen from nothing at all until now they constitute a substantial item among the expenditures of large cities.

The aid of the federal government to cities during the depression period has had two results highly favorable to the municipalities. It has enabled the localities in some small degree to maintain employment and to continue essential public services. These results in turn have assisted in some unknown measure in preventing or ameliorating economic collapse. In the second place, the federal assistance given has prevented a financial breakdown in a number of urban communities and has rendered the fiscal disaster less desperate in other municipalities. Indeed, in numerous cases, it is difficult to see how urban governments could have survived the financial demands of the 1930's without such assistance.

On the other hand, even for municipalities, federal grants for capital outlay and for relief work in particular cause trouble. In the present state of uncertainty respecting national relief policies, no budget officer can estimate

with reasonable accuracy what he can expect in P.W.A. or W.P.A. allotments.(6)

There is undoubtedly sound reason for the federal preference for dealing directly with states rather than with cities in the matter of relief financing and other assistance to state and local governments. On the other hand, cities prefer dealing directly with the federal officials rather than through state government. Perhaps the most important reason for this is the cities' sense of their own importance. However, there are other grounds. As long as grants are made for particular projects the grant must be direct unless the states supply machinery for controlling projects; otherwise a city securing federal aid would be completely enmeshed between necessary federal and state "red tape". This consideration applies to the present method of making federal subventions through state government rather than to the grant itself. If cities received federal assistance only through state governments, disagreements and difficulties between the (sometimes rurally dominated) state government and the cities would be inevitable. These, superimposed on friction with "Uncle Sam" would be highly objectionable. More serious still is the objection that municipal government is more competent or more honest than state government. It might be difficult to sustain this charge in individual states, but it would certainly be impossible to prove the contrary in certain other cases. If city government is, even in a substantial number of instances, superior in actual operation to that of the state in which the city is located, undertaking to have the city subordinated for administrative purposes would be objectionable even though not unthinkable.

It is a fair conclusion from evidence available that, objectionable as channeling federal grants through states may be on certain counts, administrative convenience and administrative history both tend to sustain the plan if, and to the extent that, federal aid may be a matter of long-run policy.(7)

State aid presents some of the same advantages and disadvantages. On the other hand such subventions, where utilized, have generally become more or less promptly a matter of settled policy. The result has been to this extent less disturbing to municipal budget practice.

The most objectionable characteristic of grants has been more frequently--as in the case of state-shared revenues and indeed federal aid as well--the sense of irresponsibility engendered in the minds of local spending officers. Either federal or state money is "easy money". This reaction seems to be enhanced by provisions for matching. It may be possible to work out a policy for state aid (or perhaps federal grants) which will minimize this influence by making the marginal requirements local in all cases. If this proves effective, a state employing a grants policy may need to diversify its objectives so that the city will have to meet marginal expenses in respect of all functions. How such a policy can be inaugurated without demoralization is not apparent.

Social policy toward both federal and state grants must rest in the future partly on financial and administrative considerations such as those which have been discussed, partly on the technical and legal developments which condition availability of taxable resources, and partly on the redistribution of responsibility for various functions of government currently in process. Considerable further study will be needed to ascertain the consequences of widely extending such a practice. At the moment, however, the secular trend is clearly, and thus far in the main constructively, toward further use of this device. That subventions have been generally considered an essential element in federal financing in other countries appears significant.

The Program

If, then, in the light of the preceding summary of tendencies and crude estimate of their significance, one must formulate a program for a particular city or the cities of a particular state or the larger cities in general, what should be recommended? Doubtless the answer, as in the case of most social situations, should be that no categorical statement is properly applicable to all situations. Existing conditions and trends, however, strongly suggest certain elements of general policy which, although highly provisional, may be conveniently stated without further analysis and without specific justification.

1. It may reasonably be expected that units of government of larger area than municipalities will continue to take over and perform functions hitherto regarded as city activities--thereby relieving the increase in local financial necessities which otherwise would be apparent.

2. The cities should continue to improve their own practices and thereby conserve their resources, as, for example, by improved budgeting and accounting, by more carefully safeguarding their deposits, by better debt administration, by better coordinated and more closely integrated administration of city affairs, including merit basis for personnel and modern organization and procedure for purchasing, by utilization of up-to-date auditing and reporting, and by adoption of improved administrative techniques generally.

3. Every city, as its primary revenue problem, should continuously emphasize improvement in property tax administration. This involves both assessment and collection machinery. Most cities need well-nigh revolutionary improvements in one or both of these functions; every municipality can effect some improvement every year and can by this means continually improve its revenue situation.

4. In some states cities may look forward to increases in receipts from taxes administered by the state governments. Absence of effective control machinery for assuring economical expenditures raises question as to the wisdom of this fiscal mechanism.

5. There is good reason to believe grants from states will and should increase, particularly in industrial and commercial sections as distinguished from those economically dependent primarily on agricultural and other natural resource exploitation. This is a normal concomitant of better state tax measures and of improved fiscal relationships between state and federal governments. The grant-in-aid technique, however, requires extensive study and in use needs careful safeguarding.

- (1) Much reliance has been placed on the Municipal Yearbook and United States Census data in respect of the facts forming the background of this discussion, but sample municipal financial reports have also been checked.
- (2) See McAneny, Dykstra, Martin and staff under J. L. Jacobs, Fiscal Relations between the United States and the District of Columbia, Sec. 9 and the materials cited therein.
- (3) Loc. cit.

- (4) Ibid., secs. 10 and 11.
- (5) For reasons made clear in Martin and Stephenson, "Aspects of the Movement Toward Separation of Sources of State and Local Revenue", Tax Magazine, January-February, 1933, it seems unwise to me that the state government should relinquish property levies completely.
- (6) Even policy with respect to C.C.C. camps is not without significance to large cities irrespective of the fact that they do not receive direct subventions thus, and what would be done respecting these camps and other related federal activities, as well as matters of grants, has not always been crystal clear well in advance.
- (7) On this point see especially standard works on grants-in-aid by MacDonald, Key and the report of the National Resources Committee on the division of the costs of public works.

GOVERNMENTAL ACCOUNTING SURVEYS

Donald C. Stone
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The subject assigned this morning on financial surveys and installations is at least a novel one. We meet together to discuss principles of accounting, budgeting, discuss particular problems, but we never have, to my memory, either in Municipal Finance Officers Association or in the American Institute of Accountants discussed the technique of surveying and installing financial systems. As a matter of fact, there isn't any literature on the subject. I know of one article in a municipal league journal on making accounting installations, but that is the only published document with which I am familiar. Partly to help fill this gap, Public Administration Service will shortly publish a manual on the installation of accounting and finance systems in schools. This document does not deal so much with the type of systems to be installed, but rather with the particular steps to be followed in appraising present conditions, in determining what kind of system ought to be designed, and in putting such a system into operation.

The Chairman spoke of the work of the National Committee on Municipal Accounting and its splendid publications. We are in a position in this country of having developed good practices. We have a large volume of literature in the field. But there are all too few jurisdictions that are actually conforming with best practice. Thus, we find ourselves in a situation where of all the cities in the country, probably not more than ten or fifteen per cent have what we might consider to be adequate financial administration. Perhaps not more than a few score of the 3,000 counties in the country have really modern accounting procedure. Certainly less than half of the states have adequate financial management. And you all heard about the Federal administration last night. The proposals of the presently debated reorganization bill are sound in that they divorce accounting and auditing by replacing the irresponsible office of comptroller general with an auditor general responsible to Congress and by placing the administrative phases of accounting in the Bureau of the Budget.

Every jurisdiction presents different problems. Although we may proceed from the same general principles in determining what system should be installed, we must take into consideration existing peculiarities: the size of the county, city, or state, type of governmental structure, functions and services performed, even the character of personnel that is available to administer the system, because whether we like to recognize it or not, we must frame our procedures with due reference to the ability of the employees to operate them. Certainly there is a real danger in the development of systems which are too elaborate for the personnel of the particular jurisdictions to administer. As a result, it is impossible to prescribe any single system for more than one jurisdiction. We may begin with the same basic plan, but we must make very substantial adjustment if we are going to be realistic in our approach. It is desirable to capitalize as much as possible upon the experience and the procedure which is already in practice. No matter how bad the financial administration may be in any government, there are usually some good features about it, and to the extent such can be utilized, to that extent will there be ready acceptance of the new system and an understanding of what is being proposed.

I would like to suggest in approaching this problem, the need for a recognition - and recognition is frequently lacking - that financial administration has no end in itself. It is a tool of management, and to the extent that the accounting, budgeting, treasury, purchasing, and other fiscal processes are geared to management and management actually uses them, to that extent will we have good financial administration. Contrariwise, if financial management is approached from the standpoint of supplying a check upon management - a negative point of view - it will fail in obtaining the real objectives we have for it. So in designing any system, in determining the type of organization, we should keep uppermost the thought, "How is this going to fit into the general administration of the government? Is it going to facilitate good administration? Are we going to set it up so the mayor, city manager, governor, or other administrator will have use of it?"

Distinction Between Survey and Installation

It is difficult to draw a line between the subject of "installation" which Mr. Andrews is going to discuss and this question of "survey". As a matter of fact, an installation must go through the survey stage, but in a survey it is not necessary to go through the installation stage. May I give two examples of the difference. Recently as a part of a general state reorganization in Kentucky, Public Administration Service was responsible for establishing a new system of financial administration, which entailed organizing a state department of finance. There had been no finance department previously. We had to determine what its activities would be, provide for the various positions in the department, and design in detail new budget, accounting, purchasing, and other procedures, and then in addition, it was our responsibility to put into effect and to supervise the initial operation of the entire system. That is what we call an installation. There were no reports prior to installation. We developed working papers, bulletins, instructions, regulations, but there was not a survey report. When the job was finished, in the light of the fact that there is very little information available on state fiscal practice, we prepared a handbook on financial administration, describing the system established.

Now in contrast with that approach is a project which has just been completed in the State of Michigan, where Public Administration Service has made a survey of state financial administration and has prepared a report of findings and recommendations. The report deals principally with how the state's financial system should be reorganized, prescribing a new plan of financial organization, defining new budget and accounting procedures, and setting forth new classifications and charts of accounts. Nothing has been installed. It is purely on paper. It is with this meaning that I use the word "survey". Incidentally, copies of both the Handbook of Financial Administration (Kentucky) and of the Report on Financial Administration of the State of Michigan are available through our Publications Division. We make a practice of publishing reports and monographs of our work in order to make the proposals and experiences generally available to public officials, professors, and others.

Preliminary Steps

Whether it be an installation or a survey, the first task is to define what is going to be done. We frequently have a difficult time in finding out from officials exactly what it is they want. They will say, "We want a complete job," but a complete job will mean something different to everyone who uses the term. The person who is to make the survey must take considerable initiative in reviewing

present practices. The best way to secure a quick picture of present practices and problems is to study the budget. The budget tells a tremendous amount about a municipality, county, or state. The form of the budget tells you how the government handles personnel, purchasing, stores, motor equipment, capital improvements, and how departments and services are organized. One can see what administrative practices are followed or ignored, that is if he is familiar with governmental processes and their budgetary treatment.

After a review of the budget, the next step is to inspect the financial organization and accounting records. It is important to find out what is prescribed in the constitution or state laws, city charters, and ordinances. After determination of the scope of needed change and how far the officials would like to go, you can work out definite specifications for the job. It is desirable that these specifications be rather precise. Otherwise, you are likely to be involved in considerable uncertainty as to how far the officials expect that you carry the work.

Once there is an agreement of what is to be done, then the next job is to organize the survey. The first step followed by Public Administration Service is to prepare what we call a "working procedure". Working procedures are detailed specifications of steps to be followed in the conduct of the work. They enumerate all of the things that we are going to inspect, all of the documents that require review, and they set forth in detail the problems that are likely to be encountered. The working procedures also include a preliminary outline of the report or of the memoranda, bulletins, etc., that are required to complete the job. In addition, schedules are needed showing the staff assigned to the job, the number of staff days, and what their particular responsibilities will be. The work also requires careful time scheduling.

We have found the success on these jobs to depend in considerable measure upon how well they have been planned in advance. Unless there are definite objectives towards which all energies can be directed, you are quite likely to overlook necessary features of the work, and you are apt to place unbalanced emphasis upon the various segments of the survey. It is essential in scheduling staff to secure a proper combination of personnel. It is uneconomical to restrict the job to seniors. On the other hand, if you have too many juniors, the work will fail at the point of supervision and technical integrity. We have given careful study to this problem of balance in staff and find that every project must be organized with reference to its special problems and conditions. We have come to a conclusion, however, that on every major project there should be at least one staff member who has a good background in public administration - in the operating side of government. Unless there is on the staff an appreciation of the objectives of the various public services being rendered, it is difficult to frame the financial system so that it will really be a tool of management.

Steps in the Survey

Let us look at some of the steps that would be set up in the working procedures - that will need to be covered in the conduct of any survey. The first step is to study the state laws, the state constitution, the city charter, the city ordinances, and any other regulations which govern the financial procedure. Here we are interested in several questions. We need to know where the responsibilities for each stage in fiscal administration are placed - what is required of the separate offices in terms of organization. The next question is what are the

requirements concerning accounting practice. In most states and cities a great deal of procedure has been embodied in laws. We have foolishly tried to administer government by edict and have failed to provide for competent personnel with adequate discretion in administrative matter. In any survey or installation such legal restrictions may prevent prescription of a proper system. New drafts of legislation and charters may thus be an integral part of any survey.

Another important question which is often controlled by law is the segregation of funds. Law makers are constantly tempted to prescribe special funds and accounts even where they defeat good financial control. While segregation of trust and special expenditure funds is proper, the number of funds ought to be kept at a minimum. Thus one of the principal problems is not only to discover what is required by law but also to determine how simple the fund structure can be made. Over a period of time in most municipalities and states, one fund has been added after another until a point is reached where the system is so cumbersome that it prohibits any flexibility and serves as an obstacle to good management.

After all legal requirements and other background considerations have been appraised the next job is to analyze the existing system. The first move is to find out how fiscal administration has been organized in the light of the legal requirements. It is amazing to discover the large number of differences between actual practice and what is prescribed by law. As a matter of fact, the study of current practice will generally reveal many violations of legal prescription. It is desirable to chart the organization in detail, set up definitions of responsibilities and duties of each employee, and determine the inter-relationships between the account, budget, treasury, revenue, purchasing, and other branches of the fiscal system.

Another question requiring study is the budget calendar. What are the steps that are followed with respect to preparation of revenue and expenditure estimates, budget hearings, framing budget documents, submission of the budget to the legislature for enactment, etc.? What is the time sequence of these steps?

What are the methods employed in securing these revenue and expenditure estimates and in framing the budget itself? Are appropriations lump sum or detailed? Once appropriations have been made, what is type of budgetary control that has been maintained? What problems are encountered in the execution of budget - allotments, transfer of funds, inter-fund transactions, - and arise in day to day operations?

Then there is the classification of accounts - the question of what type of classifications are in use - by organization units, by character, by object of expenditure, by type of functions and activities. Seldom do we ever find satisfactory classifications. Generally the classifications are all mixed up and complete revision is required. Good fiscal control can not be attained in the absence of satisfactory budget and accounting classifications.

Very frequently we find insufficient distinction between the budgetary accounts and proprietary accounts. At this point there is a great difference between governmental and commercial accounting. Another problem revolves around the degree of centralization of accounting. What work should be conducted in the

central office and what decentralized in departments and institutions? Who has authority to prescribe the records and the accounts in the departments?

The establishment of proper interrelationships between cost accounting, budget office, treasury, revenue administration, purchasing, and other phases of fiscal operation is always a tricky problem. In one jurisdiction separate and independent officers may be administering each phase. This raises the question as to how separate may they be and still secure effective management. What should be the relation of the various officers responsible for these several phases of fiscal operations to the chief executive?

With respect to accounting proper, a variety of problems are encountered: the character of the general ledger, journals and accounts of record, encumbrance and expenditure documents, accounting procedure, pre-audit practices and steps that are followed preparatory to disbursement to assure that disbursements are for a proper purpose, are appropriately authorized, and observe prescribed form. Then in contrast to the pre-audit which is an administrative responsibility, we have the post-audit - an independent check on the administration as to the accuracy of the accounts and to the legality of individual transactions. Then there are a variety of special problems that cannot be ignored - travel expense, petty cash, inter-fund transactions, procedure for making disbursements, receiving and controlling funds, selection of depositories, inter-depository transfers, method of accruals, payroll procedure, accounting for equipment and stores, accounting for properties, and cost accounts. Finally there is this whole problem of financial reporting which is one of the major objectives of any financial system. Though statements are indispensable in accounting control, they are even more important for general management purposes of the governmental agency itself.

After all of these problems have been surveyed and it is decided what type of changes out to be made, then we encounter the task of designing the new system - preparation of the report of findings and recommendations. The preliminary outline of the report prepared at the start will need constant revision as the investigation proceeds and unforeseen problems are met. This process of outlining the report may not be left till the end, because unless we have the final pattern constantly in mind, we will end up with a report which is unbalanced and which will in fact, leave out important recommendations.

In solving some of these problems, alternate solutions will often be applicable. We often discuss such alternate methods with the officials letting them decide which they prefer. Participation by the officials in the survey or installation will aid them in understanding what you are trying to do, and they will be in a much better position to carry on after the survey or installation has been completed. We make a practice of clearing drafts of our final reports with the officials prior to formal submission, for no matter how careful one may be, errors are apt to creep into the report or there may be unforeseen difficulties in the application of certain recommendations.

Common Deficiencies in Surveys

In addition to the foregoing observations, a number of defects or deficiencies are frequently encountered in financial surveys. Proposed changes in fiscal systems are made too often purely from a technical accounting point of view and not sufficiently from the management point of view. Among the principal deficiencies found in financial reorganizations are the following: First,

is the setting up of fiscal offices independent of the chief executive. No step may do more to impair good financial management than this. We have encountered many cases where the chief executive desired to improve the finance system, but this proved impossible because one or more fiscal offices had independent status and were in fact responsible to no one. Therefore, where local conditions have permitted, we have placed the financial system under the control of the chief executive just like any other management tool, separating at the same time the function of auditing by making it a responsibility of the legislature.

In the second place, the needs of financial reporting are frequently overlooked. We set up accounting and financial procedures, but fail to make provision for the type of reports that officials will actually use in controlling and directing public services. The reports are too detailed, technical, and are not geared to management needs. Classifications are often too academic. Preparation of suitable classifications for a government is a tedious job. There will always be a temptation therefore to apply classifications of the National Committee on Municipal Accounting or of other agencies to jurisdictions without making the many adjustments which local conditions require.

Third, an attempt is often made by persons inexperienced in government work to apply private accounting principles and practice. As already mentioned, governmental finance and accounting differs in many respects from the profit and loss procedures of private business. Fourth, the systems tend to leave out important phases of fiscal administration. Accounting records are frequently revised without making corresponding adjustments in budgeting, purchasing, treasury, etc. The financing and accounting for stores, motor equipment, and properties are seldom provided for. In fact, most systems, due to the shortcomings of the individual who installs them or to the failure of the public officials to appreciate the need of a rounded job, most surveys and installations are only partially complete. It is frequently impossible, or the situation isn't ripe, to secure agreement that all of these interrelated features of fiscal administration will be tied up at the start into a unified system.

I have already mentioned the fact that too often the officials who operate these systems are not consulted sufficiently during the course of the work. It is our practice where time and other conditions permit to draft alternate forms and to secure preference from the personnel who handles them. Where individual employees have played a part in the design of the system, they will tend to be more loyal to the changes.

The reports of findings and recommendations generally leave much to be desired. Too often they are chiefly descriptions of what was found in the jurisdiction rather than what ought to be done. Many of the reports are badly organized, they are too complicated, and sometimes they are so technical that the officials are unable to decide whether or not the recommendations should be put into effect. Each report must be designed to fit psychological as well as technical consideration. Where action is desired from general management and legislative officials the reports must be written from their viewpoint. Report writing in itself is an art and may have no relation to technical accounting ability.

Finally, there are certain prerequisites which underlie constructive accomplishment quite aside from these matters to which I have already referred. First, there is no use going into a jurisdiction and making an installation unless

the officials actually want it. Sometimes officials are pushed into a corner and will arrange for a survey which they will never use. It is always profitable to test whether the administrative and financial officials really want the job done. Second, it is essential to secure mutual understanding as to what may be involved in the changes. The third, prerequisite for a good job is that the chief executive have or be given sufficient control over all of the fiscal operations that a unified system can result. The fourth need is a genuine desire to carry through the proposed reorganization. If there isn't that desire or ability to do it, no constructive result will take place. Reports will have no other disposition than the waste basket or dust gathering on book cases. Five, it is imperative that competent technical assistance be secured at both the survey and installation stages if revised procedure or a proper character is to result. Financial officials burdened with day to day operations do not have time either to plan broad fiscal changes or to install the changes once a new system has been developed.

ACCOUNTING CONTROLS IN
THE FEDERAL GOVERNMENT

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Note: The full text of Mr. Bartelt's paper is sent separately as a supplement to the Proceedings of the Conference on Municipal Accounting and Finance.

THE TECHNIQUE OF MUNICIPAL ACCOUNTING INSTALLATIONS

T. Coleman Andrews, C.P.A.

Devising and installing an accounting system is like designing and building a house. There is not only the obvious similarity of function between the systematizer and the architect but also the similarity of a common problem. This common problem is to be found in the fact that almost everyone who has anything to do with business administration, whether it be public or private, knows something about accounting. Consequently, the systematizer does not work in a field with which his client is not familiar. Because everybody lives in a house of one kind or another, everybody has some sort of an idea of what kind of a house he would like to have when he gets ready to build. Thus the systematizer and the architect usually get a lot of advice and often a lot of unsound positive instruction from their clients. All of which should make the systematizer and the architect highly envious of the doctor and surgeon, and, to a less degree, envious of the lawyer, because these technicians work in fields not so familiar to their patients and clients and so are in position to do pretty nearly all the directing.

There is still another point of similarity between the systematizer and the architect in that systems, like buildings, often are started and carried thru to completion without plans. Consequently, desirable and oftentimes necessary features are not thought of until the structure is complete. The most classic illustration of this occurred in the building of one of the large hotels in Washington. When it was finished or thought to be finished the builder suddenly discovered that no provision had been made for a power plant. There wasn't even a chimney or smokestack. The builder must have thought he was working at Miami, with apologies to our brethern from California.

This may sound facetious and to a certain extent it is intended to be funny but the illustration I have given actually occurred and I cite it to indicate one of the most common deficiencies of system installations, namely, unplanned building.

Perhaps the next most common deficiency in system installations is the result of the tendency to start at the wrong end. There is little hope for the success of any undertaking that starts at the wrong point. The development and installation of a system, like every other undertaking, should start at a definite point and be prosecuted toward a definite goal. The starting point should be the chart of accounts and the goal should be a system and series of procedures that will assure the final assembling of the accounting facts afforded by the accounts in the reports that are to be prepared therefrom.

The time allotted to me is too short to permit digression but I will take the liberty of digressing at this point for a moment to point out that to provide the accounts necessary for the recording of the transactions of a business is not sufficient. To be really effective an accounting system must be supplemented by reports. Thus, accounting and reporting go hand in hand. They are the Siamese twins of business administration. You can't separate them without endangering the life and usefulness of both. Financial facts are accumulated by accounting and displayed by reporting. It is like motion pictures; the camera isn't worth much without the projector.

But neither accounting nor reporting are capable of cerebration. I cannot too strongly emphasize this statement because accountants have fallen into the error of claiming too much for their systems. They have all too often represented system to be the end of profit making, when, as a matter of fact, it is but the means thereof. Accounting furnishes the instruments by which direction and position are ascertained, and financial reports are the charts to which the readings of direction and position are reduced. But neither accounts nor reports can do management's thinking. If management is incapable of using its instruments or reading its charts, the Ship of State just drifts.

This suggests the cause of most of the inefficiency of public administration but this is still another subject and I won't get off on it. I will simply take this opportunity to say regarding it that the problem has been very effectively attacked by the Municipal Finance Officers Association of the United States and Canada and other organizations in the field of public administration, including the National Committee on Governmental Accounting, with results to date that warrant the confidence that the time is not far distant when the administration of public affairs undoubtedly will be on a par with the administration of private affairs.

Getting back to where we turned off. The primary objective towards which the systematizer should work is the laying out of forms and the procedures for handling same so that assets, liabilities, revenues, and expenditures will be accumulated as contemplated by the chart of accounts; and I might say also that, as far as possible, the accounts should be listed in the chart of accounts so that the information required by the financial reports may be available from the accounts in at least approximately the same order that this information is called for by the reports.

Nothing is more necessary to the success of a system than well planned and faithfully executed flow of data from the inception thereof to the recording of same in the accounts. Efficient personnel is necessary all along the line but I should say that efficient clerks who handle the paper work required by a system up to the time of actual entry of transactions in the account are more essential to accurate bookkeeping than efficient bookkeepers. As a matter of fact, to put it frankly, a high salaried bookkeeper is not necessary when the documents from which bookkeeping entries are made are properly prepared, since all the bookkeeper has to do when the documents from which entries are made are properly prepared is simply follow instructions. One doesn't have to be a bookkeeper to know where to post an entry if the instructions for the entry are clear.

This is important to accurate and expeditious accounting because over-emphasis of the qualifications of bookkeepers and under-emphasis of the qualifications of the clerks who handle the paper work leading up to the bookkeeping invariably throws a large amount of the work on the bookkeeper and consequently causes a jam in the bookkeeping department; and a jam in the bookkeeping department means that the bookkeepers have to work under pressure, thereby increasing the possibility of error and delaying the closing of the books and preparation of reports. I say, therefore, that careful planning and efficient execution of the paper work leading up to the recording of transactions on the books is more necessary to an accurate bookkeeping result than the bookkeeping itself.

This brings me to another obvious point, namely, that elaborate manuals of accounting procedure, insofar as they relate to bookkeeping, are a waste of time and money. There isn't an accountant who doesn't look with pride upon the accounting manuals which he furnishes with his systems, but when you get right down to it and consider the matter dispassionately you will find that such manuals seldom are used after they are prepared. However, insofar as these manuals cover the handling of the paper work leading up to the bookkeeping, they are important. Thus, the flow chart becomes of primary importance.

To illustrate what I mean by a flow chart, let us consider the progress of an expenditure from its inception to the recording thereof on the books of account. A department head finds he needs to buy an automobile. He issues a requisition on the Purchasing Agent. The Purchasing Agent receives this requisition and before ordering the automobile he ascertains from the Chief Accounting Officer, usually known as the Comptroller, whether the budget of the department from which the requisition is received carries provision or authority for the purchase of the automobile and whether the appropriation balance to the credit of the department is sufficient to permit the purchase. If the purchase of the automobile has been provided for in the department's budget and there is a sufficient appropriation balance to the credit of the department to permit the expenditure, the Comptroller approves the requisition, notes thereon the appropriation account to which it is to be charged and returns it to the Purchasing Agent. The Purchasing Agent obtains bids and makes the purchase or purchases under a pre-arranged contract, if such a contract has been executed, and notifies the department from whom the requisition was received. When the automobile is delivered the department for whom it is purchased notifies the Purchasing Agent, the Purchasing Agent then checks the invoice for the automobile and certifies it to the Comptroller along with the requisition and other papers which have been accumulated in connection with the transaction. The Comptroller then approves the invoice for payment and sends it to the disbursing officer. The disbursing officer pays it and the transaction is complete.

In stating the progress of this matter I have purposely omitted all accounting procedure so as to indicate clearly the clerical routine thru which such a transaction normally passes. All this routine is susceptible to reduction to a flow chart showing the origin of the transaction and the different hands thru which it must pass and the different documents that are accumulated as it goes from hand to hand until it is finally complete. All too often the importance of this routine is overlooked. Obviously, if the prescribed routine is faithfully observed, such accounting entries as the transactions necessitate become simple matters.

We come now to the question of machine accounting versus manual accounting. No one in these times thinks of accounting for a large enterprise except in terms of machine operation. It should be remembered, however, that almost any accounting job that can be done by machine can be done by hand and that the question whether a system shall be manually or mechanically kept usually resolves itself into a question of cost. Machine methods ordinarily cost less than manual methods, but there are some operations which can be done at lower cost by hand and still others that can be done at lower cost by joint use of manual and mechanical methods. The latter is particularly true of sorting. This is true in spite of the remarkable progress that has been made in mechanical methods of sorting. However, in view of the increasing use of machines, and since we must necessarily

develop this subject in terms of large operations where mechanical methods ordinarily are more efficient than manual methods, we will consider only machine applications.

It may also be said of machine applications that regardless of the difference in cost thereof over manual applications, machines ordinarily accomplish the desired result quicker and with fewer possibilities of error, and, even where the cost of the two methods might be the same, hardly anyone would use manual methods when machine methods will produce the desired result quicker, because there is nothing more disconcerting to management than to have to contend with figures that are produced so long after the transactions have been completed as to make them Ancient History and therefore of somewhat delayed value from the management point of view. At the same time there is something to be said for manual methods in this day of extensive unemployment. I don't subscribe to the idea that we should cling to out-moded methods merely to create employment but there is no inconsiderable school of thought whose thesis is that efficiency alone should not be the goal of management.

There are, of course, all kinds of machines. It would be impossible to cover all of them in the time allotted to me. Therefore, we must leave out of consideration a great many of them. Let us consider, however, for a few moments the modern posting machine. It is perhaps improper to refer to this machine by such a limited title as a posting machine since most of the posting machines on the market can be used for a number of operations other than posting. However, posting is the principal feature of them.

This type of machine has emancipated the accountant and the bookkeeper from at least two irksome jobs. It has obviated the necessity for extensive multi-column books of original entry and in doing so has done much to reduce the month-end jam which formerly caused so much of the delay in closing books and getting out financial statements. In addition it has made possible the production of several accounting records at one operation.

The posting machine has eliminated the necessity for multi-column books of original entry by making it possible to post individual transactions in detail and, as a by-product thereof, obtain automatically the balance of each account posted, so that when the end of the month comes little is left to be done except take off the trial balance and close the books.

By being able to use this type of machine to produce several records at one time many steps in the process of getting entries on the books have been eliminated. For instance, to use a simple illustration, it is possible to produce on one of these machines, a payroll check and at the same operation post the employee's salary to his earnings account and create a proof sheet which may be used as either the underlying or secondary payroll record.

In the same manner other books of original entry can be created at the same time that the items recorded in these books are posted to the accounts. For instance, the average municipality gathers its receipts and other revenues thru several different offices and employees. The items shown in the daily, weekly or other periodic reports of these officers can be posted direct from the reports to the ledger accounts and at the same time there can be created a proof sheet which may be used as a cash receipts book.

Needless to say simplicity of this kind facilitates not only the account-keeping but also the auditing of the accounts.

Now as to the designing of the accounting forms. Too often this job is left to the representatives of the business machine manufacturers. I don't say that this is not satisfactory in all cases because the business machine manufacturers have some very excellent form designers. I will say, however, that the designing of forms to be used in an accounting system is one for an accountant because the object of a system installation is to accomplish the gathering of financial facts in the manner contemplated by the chart of accounts. It is not just a matter of installing a machine. The representatives of business machine manufacturers are not trained to do this. They are trained to adapt their machines to specified requirements. The accountant, however, should work closely with the representatives of the business machine manufacturers to the end that the most practical adaptation of the machines to be used in any given system may be worked out.

In designing forms for an accounting system the designer must know not only what the various accounting machines will do but also something about printing practice. He must know, particularly, the standard sizes and grades of paper so that the forms designed by him may be cut from standard size sheets with a minimum of waste. Also that the right kind of paper may be used for each form. Printers are in the business not only of printing but also of selling paper. Naturally, they are going to try to sell the best job they can, but obviously there is no point in using bond paper where a cheaper grade will serve the same purpose. Also take the matter of the grain of paper. Forms that have to be inserted in machines should be cut so that the grain runs from top to bottom. If the grain runs from side to side the sheet will have a tendency to buckle. This is particularly true of heavy bond papers that are used for ledger accounts.

The system designer also should know something about paper and ink colors so that color combinations may be furnished which will cause a minimum of eyestrain. The contribution of eyestrain to fatigue is very much greater than is usually supposed, and everyone knows that fatigue reduces efficiency. The same may be said about lighting. Scientific studies of lighting have shown that efficiency is substantially reduced when the requisite amount of light is not provided.

Finally, let me urge upon you the importance of simplicity not only in system design but also and more particularly in the designing of financial reports. Let me caution you particularly about trying to put too much information in a single report. There is a great tendency on the part of accountants to try to combine facts and statistics in one report. Usually the effect of this is just the reverse of what is intended. The reader is faced with so many figures that the report is confusing. A busy executive looks for results first and details second. Not long ago the Mayor of one of the most efficiently managed cities in the country specified that the Comptroller's monthly reports to him should be "one page" reports. He said he didn't want to have to wade thru a lot of details to get at a result. This problem was solved by furnishing him a very simple summary report with schedules of details attached.

Nor does a busy executive want his accounting facts and statistics all thrown together in one report. An executive worthy of the name usually is capable of putting accounting and statistical reports together and drawing reliable conclusions therefrom. Any executive who can't integrate separate accounting and statistical reports would be utterly lost with a report which combines accounting and statistics.

RESOLUTION

The following resolution, introduced by Hiram T. Scovill, C.P.A., president of the Illinois Society of Certified Public Accountants, and professor of accounting at the University of Illinois, was passed at the afternoon session of the Conference on Municipal Accounting and Finance on Tuesday, March 29:

WHEREAS, The national Conference on Municipal Accounting and Finance was called by the American Institute of Accountants for the purpose of discussing and bringing to public attention the need for better business and accounting methods in the fiscal management of cities and towns, and

WHEREAS, Conditions exist in many cities which defeat the purposes of good management and sound accounting, causing in many cases misinformation as to the true financial position of local governments, and

WHEREAS, Those attending this Conference on Municipal Accounting and Finance recognize an obligation on their parts to do all they can constructively to improve the business and accounting methods employed by those many municipalities which need improvement and education, be it

RESOLVED, That this Conference go on record as favoring the widest possible publicity for the financial affairs of communities and as favoring also a campaign of education by the groups cooperating in this Conference to the end that the public and municipal officials alike will demand improvement where it is needed, and be it

FURTHER RESOLVED, That the general public be urged to take more interest in the financial reports of local governments and to give more study to these reports, to the end that they shall be in every case efficiently prepared and honestly reflect the conditions with which they deal.