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NCGA RESEARCH STUDY

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OBJECTIVES OF  
ACCOUNTING AND  
FINANCIAL REPORTING FOR  
GOVERNMENTAL UNITS:  
A RESEARCH STUDY

VOLUME II

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**THE QUALITY OF FINANCIAL REPORTING BY  
GENERAL PURPOSE LOCAL GOVERNMENTS****W. D. Haseman and R. P. Strauss<sup>1</sup>**

## INTRODUCTION

For a considerable period of time, local governments in the U.S. have had access to a number of guidelines with regard to the manner of preparation and content of their financial reports. As the size, complexity, and expense of local government have grown, so too have the information needs of public managers, the citizenry, and other important actors in the financing of the public sector.

Public and Congressional interest in the financial reports of local governments has heightened in the last twenty years for several reasons. First, a number of major municipalities (e.g., New York and Cleveland) have encountered serious financial difficulties which resulted in their being denied access to capital markets. In many instances, the financial reports of these jurisdictions did not permit the general public to appreciate their precarious situation until it was too late. In response to pressures brought by lenders, these jurisdictions have had to alter materially and improve their reporting practices.

Federal interest in the reporting practices of local governments has increased for several reasons. With the explosion of grant in aid money from the federal government to state and local governments since the early 1970's, the federal government has felt the obligation to ask jurisdictions to account for the usage of federal funds. With the advent of large-scale block grants, such as general revenue sharing in the early 1970's, there



has been increased need for the federal government to be assured that such financial flexibility, which has increasingly been provided to local governments, has been utilized by local governments in a manner consistent with the general principles governing their financial operations.

For example, in 1972, the Congress, in providing general revenue sharing funds to local governments, required that they spend their funds in accordance with applicable state and local law.<sup>2</sup> This requirement has meant that federal funds had to be budgeted and appropriated in the same manner as funds derived from local tax sources. In 1976, the Congress also required that local governments use their revenue sharing monies in a nondiscriminatory manner with regard to employment by race, sex, disability, etc., as well as in regard to any expenditure of the funds for public services.<sup>3</sup> These additional requirements in turn created greater reporting needs on the part of recipient units of local government and affected their financial reporting practices. In 1976, again through the general revenue sharing legislation, the Congress required state and local governments which received more than \$25,000 in revenue sharing payments to have (once within three years) an independent financial and compliance audit of the unit's financial statements, according to generally accepted accounting principles.<sup>4</sup> To achieve compliance, local governments subject to the audit requirement reported the results of the audit either to a state agency designated by the Office of Revenue Sharing or to the Office of Revenue Sharing directly.<sup>5</sup>

Since 1976, Congressional interest in the single audit concept of local governments for federal purposes has increased. While no additional legislation has been enacted, the Office of Management and Budget issued, through Attachment P to OMB Circular A-102,<sup>6</sup> a requirement that recipients of Federal aid be audited on an organization-wide basis rather than an agency by agency basis.

Related to the growing federal interest in local governmental financial reporting and accounting practices has been the

publication of a number of related studies of current practices. The General Accounting Office has done several studies,<sup>7</sup> and most recently, Ernst and Whinney<sup>8</sup> published a study which has sought to indicate emerging problem areas in the financial reporting practices of local government. What limited empirical information is available suggests that emerging problems of local governments with respect to their management of capital funds and pensions are reflected also in the reporting practices related to these two matters.

A limitation of the GAO and Ernst and Whinney studies is that they are not based on random samples of local governments. For example, the Ernst and Whinney study reflects the reporting practices of 100 large municipalities, and therefore did not reflect the practices of county governments or township governments which are important forms of local government in many parts of the United States. Beyond the matter of representativeness of the jurisdictions sampled, there is a range of issues which previous studies have not examined, such as the relationship between the quality of financial reporting and the type of auditor utilized. We seek in this study to remedy several of the shortcomings of earlier studies by undertaking a random sample of local governments throughout the United States and examining a wide range of issues related to their financial reporting practices.

The paper is outlined as follows: first, we describe our sampling technique and methodology; next, we provide the basic results of our sample in terms of the compliance of local governments with generally accepted accounting principles (GAAP), and the additional disclosures recommended in the 1968 publication of Governmental Accounting, Auditing and Financial Reporting (GAAFR), the description of the type of auditor employed by various units of local government, the nature of audit opinions and their qualifications, and finally the extent to which generally accepted accounting principles were followed; we then describe relationships between the extent of compliance with GAAP and GAAFR by type of



auditor and the relationship of qualifications of opinion to these; finally we summarize and discuss the implications of these empirical results for the promulgation of new standards and in relation to the conceptual work currently underway by the National Council on Governmental Accounting.

#### SAMPLE AND METHODOLOGY

##### Objectives of Sample Design

As indicated above, an important objective of this study was to characterize empirically the reporting practices of local governments throughout the United States. To achieve this objective, it was necessary to identify the proper population from which to draw a sample of local governments. The U.S. Bureau of the Census recognizes two basic types of local governments: units of general local government, and special districts. Within the category of general local governments, of which there are about 40,000, the Bureau distinguishes among county governments, city governments, and township governments.

We are interested in this study in general purpose local governments. Within these 40,000 governments there are great variations in activity level in terms of employment, taxation, public expenditure, or population being served. Because functional responsibilities vary dramatically across the country, population per se would not be a good indicator of the overall activity level of a particular type of local government. For example, in some states, county governments, which necessarily encompass large numbers of individuals, may not be very active in providing services. In other states, especially in the Southeast, county governments are the predominant source of local services.

We wish to limit the study to what we consider to be "fiscally active" governments. Accordingly, we define our sampling universe

of governments in terms of their receipt of revenue sharing payments. In addition to stratifying the sample on the basis of the type of government (county, city, or township as defined by the Bureau), we stratify on the basis of whether or not the state played a role in assisting the Office of Revenue Sharing with the application of the 1976 Audit Requirement, although subsequent inspection of the results did not reveal significant differences between jurisdictions' reporting practices in the two types of states.

#### Sampling Frame

From the Census Bureau we obtained a list of more than 12,000 local governments which received more than \$25,000 in revenue sharing payments. This group constituted the universe of "fiscally active" local governments. This universe was then divided into six strata, corresponding to the type of local government (county, city, township) and whether or not the state played a role in assisting the Treasury Department with the audit requirement. Within the six-way stratification, local governments were ordered by their total revenues collected as reported to the Census Bureau for the Entitlement Period 6.

On the basis of this six-way stratification, a sample of 464 jurisdictions was drawn and a written request made for their financial reports for Fiscal Year 1978-9. Overall, 168 responses or 36% were received without followup. In general, the population and revenues of the respondents were greater than those of nonrespondents; however, difference between means tests of the respective populations and revenues did not reveal statistically significant differences between the two groups for most comparisons. (See Table 1). We conclude that the respondents are reasonably representative of the population of "fiscally active" general purpose local governments.

On average, the counties which responded contained roughly 636,000 people in 1975 and raised \$91.3 million in revenues in



Table 1 Differences Between Means Tests  
for Non-response Bias<sup>#</sup>

Test Variable	Type of Government		
	Counties	Cities	Townships
Population	-3.21*	-1.40	-1.32
Revenues	-0.68	-1.02	-2.15*

\* Reject the null hypothesis that there is no difference between respondents and non-respondents at the 95% level.

<sup>#</sup> Test statistic is:

$$\frac{\mu_1 - \mu_2}{\sqrt{\frac{\sigma_1^2}{n_1} + \frac{\sigma_2^2}{n_2}}}$$

where  $\mu_2$  is the mean from the respondents and  $\mu_1$  is the mean of the sample population.

Table 2 Mean Population and Revenues\*  
for Survey Respondents by Type of Government

	Counties	Cities	Townships
Population	635,695	288,787	72,966
Revenues (millions)	\$91.260	\$144.086	\$7.226

\* Based on Entitlement Period 6 data from survey respondents

fiscal year 75-6; on average, the cities which responded contained 289,000 people in 1975 and raised \$144.1 million in FY 75-6, while the townships which responded contained about 73,000 people in 1975 and raised about \$7.2 million. (See Table 2).

The respondents permit us to generalize about the population of general purpose local governments which we deemed to be "fiscally active." In terms of the universe of all general purpose local governments, those "fiscally active" governments represent more than 95% of the U.S. population and 95% of all general purpose local revenues.

#### BASIC RESULTS

The following material represents some of the basic data collected from the financial statements. For each of the variables presented, the percentage of occurrence is recorded by type of local government, (county, city, township) as well as for the overall response. The number in parentheses at the top of the tables represents the sample size for the given category, while the numbers in the table represent the percentage of occurrence for the given category.

##### Combined Statements

A combined statement refers to a report for several funds in which a column is provided for the total of several funds. This statement is meant to provide an overview or composite of all funds and groups. During the period of time from which the sample was drawn, these statements were not required but they were recommended by GAAFR.<sup>9</sup> After June 30, 1981 these statements will become required, using the format shown in NCGA Statement 1.<sup>10</sup> The respondents' utilization of combined statements is shown in Table 3. While the actual statement format was not a concern, data were collected for various types of statements.



Table 3 Combined Statements Recommended by GAAFR  
By Type of Government  
(Table entry is proportion of respondents)

GAAFR Combined Statements	County (46)	City (94)	Township (28)	Overall (168)
Balance Sheet	.6957*	.8830**	.6429	.7917
General Governmental Revenues	.6739#	.7340**	.3929	.6607
General Governmental Expenditures	.6522#	.7553**	.3929	.6667
Cash Receipts & Disbursements	.3913	.4255	.3929	.4107
Investments	.1957*	.5319**	.0714	.3631
Long Term Debt	.5217	.5745	.6429	.5714

\* Denotes county and city proportions different at 95% confidence level.

\*\* Denotes city and township proportions different at 95% confidence level.

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As can be seen from Table 3, better than 79% of all governmental units presently combine Balance Sheets and Statements of Revenue and Expenditures; however, the remaining combined statements are presented less often by local governments. Cities tend to report combined balance sheets, more often than counties and townships; the observed differentials are statistically significant from zero at the 95% confidence level.<sup>11</sup> Cities and counties also tend to report general governmental revenues and expenditures more often than townships. Finally, cities tend to report investments more often than counties and townships. Overall, combined balance sheet statements are provided most often -- 79% of the time -- for all governments, and combined investment statements least often -- 36% of the time.

Reporting Recommended by GAAFR

In addition to the traditional accounting statements proposed by GAAFR, a number of additional reports or pieces of data are recommended, and the extent to which local governments provide these reports is shown in Table 4. As can be seen, the majority of general purpose governments provide the first four statements, (expenditure by function, general and tax revenues by source and property tax levies). Generally, cities report significantly more information than do counties and townships, and counties about the same additional information as townships. For example, half of all cities reported the ratio of bonded debt to assessed value, compared to 26% of the counties and 14% of the townships.

Auditor Type

There did not exist a general requirement for local governments to be audited which corresponds to the SEC requirements placed upon the private sector, prior to the ORS requirements. The ORS<sup>12</sup> requires governmental units who received more than \$25,000 annually in revenue sharing funds to have their financial statements audited and to submit the statements along with the audit to the Federal Government by September, 1981. This rule does not specify who should perform the audit; also, it does not require the audit opinion to be unqualified. A few states and some local governments have additional legal requirements related to auditing placed upon governmental units.

A summary of the type of auditor used by the local government is shown in Table 5. As can be seen, the majority of cities (82%), counties (63%), and townships (82%) were audited by independent CPA firms. Note that 24% of the counties and 11% of the townships were not audited at the time of the survey.



Table 4 Data Recommended by GAAFR by Type of Government  
(Table entry is proportion of respondents)

Recommended by GAAFR	County (46)	City (94)	Township (28)	Overall (168)
General Expenditures by Function	.8478	.9149	.9286	.8988
General Revenues by Source	.9348*	.9894**	.8929	.9583
Tax Revenues by Source	.6739	.7128	.7500	.7083
Property Tax Levies	.5652*	.7553	.7143	.6964
Assessed Value of Taxable Property	.3913*	.6383**	.3929	.5298
Overlapping Tax Rates & Levies	.3043*	.5638	.2500	.4405
Special Assessment	.1087*#	.4894	.2857	.3512
Bonded Debt/Assessed Value	.2607*	.5000**	.1429	.3750
Direct & Overlapping Debt	.2174*	.5213**	.1786	.3810
Annual Bonded Debt Service/ Total Expenditures	.1957*	.3404**	.1071	.2619
Schedule of Revenue Bond Coverage	.2609*	.4787**	.0714	.3512
General Obligation Debt Service to Maturity	.4565*	.7021	.6071	.6190
Debt Service to Maturity	.3913*	.5319	.3929	.4702
Schedule of Insurance in Force	.2609*	.4894**	.1786	.3750
Salaries-Officials	.2826	.3936	.3214	.3512

\* Denotes county and city proportions different at 95% confidence level.

\*\* Denotes city and township proportions different at 95% confidence level.

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Table 5 Type of Auditor by Type of Government.  
(Table entry is proportion of respondents)

Auditor Type	County (46)	City (94)	Township (28)	Overall (168)
Independent CPA**	.6304*#	.8191	.8214	.7679
State Auditor	.0652	.0957	.0000	.0714
Independent Elected Official	.0652	.0851	.0357	.0714
Not Audited	.2391	.0319*	.1071	.1012

\* Denotes county and city proportions different at 95% confidence level.

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\*\* Includes public accountants.

#### Audit Opinion

A summary of the data collected regarding the audit opinion is given in Table 6. An "unqualified" opinion means that the auditor accepted the financial statements as fairly presenting their financial activities in accordance with GAAP. The qualified opinion is also positive. However, it indicates one or more items which the auditor wishes to call to the attention of the reader, such as uncertainties on valuations of assets, litigation, or accounting inconsistencies. The "disclaimer" and "adverse" opinions are negative opinions, while the "not auditable" means that sufficient records were missing or not collected in a manner which would make an audit feasible. Table 6 indicates that 28% of the county governments and nearly 21% of the townships were found to be not auditable. In addition, a large number of the audit opinions (42% overall) contained at least some qualification.



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Table 6 Opinion of Auditor by Type of Government  
(Table Entry is proportion of Respondents)

Auditor's Opinion	County (46)	City (94)	Township (28)	Overall (168)
Unqualified	.3696	.3830	.3214	.3690
Qualified	.3261*	.4681	.4286	.4226
Disclaimer	.0435	.0106	.0000	.0179
Adverse	.0000	.0319	.0357	.0238
Not Auditable	.2826*	.1064	.2143	.1726

\*Denotes county and city proportions different at 95% confidence level.

The most common reasons given for a qualified or adverse opinion are shown in Table 7. It should be noted that more than one reason could be given for each respondent so that the column total may exceed 100%. Also, it should be noted that the distribution in Table 7 is only for those reports which received a qualified or adverse opinion. For example, of the 48 cities which received a qualified or adverse opinion, 29 or 60.4% had reports which did not follow GAAP. As is evident from inspection of Table 7, failure to follow GAAP and inadequate records are the two major reasons resulting in a qualified or adverse opinion for all three governmental types. In addition, better than 20% of the counties and cities were cited for inadequate internal control.

A further investigation of the reason for qualified or adverse opinion is given in Table 8 which indicates the specific component of GAAP which was not followed. Inadequate record keeping (41%) and incomplete disclosures (38%) were the reasons stated most often for cities. It is also interesting to note that overall 31% of these governments did not use the accrual or modified accrual bases of accounting.

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Table 7 Reason given for Qualified or Adverse Opinion  
by Government Type  
(Table entry is proportion of respondents)

Reason for Qualified or Adverse Opinion	County (17)	City (48)	Township (13)	Overall (78)
Non-GAAP Principles	.4705	.6041	.8461	.6153
Inadequate Records	.5294	.4583	.3846	.4615
Uncertainties Caused by Litigation	.0588	.1666	.0000	.1153
Change in Accounting Principle	.1764	.1666	.1538	.1666
Noncompliance with Legal	.0000	.0416	.0000	.0256
Inadequate Internal Control	.3529	.2083	.1538	.2307
Other Reasons	.0588	.1458	.0769	.1153

Table 8 Reason given for Non-GAAP Specification  
by Government Type  
(Table entry is proportion of respondents)

Reason for those Specifying Non-GAAP	County (8)	City (29)	Township (11)	Overall (48)
Did Not Use Accrual	.3750	.3103	.2727	.3125
Incomplete Disclosure	.2500	.3793	.3636	.3541
Improper Capitalization	.1250	.2758	.2727	.2500
Inadequate Record Keeping	.2500	.4137	.1818	.3333
Others	.3750	.2068	.6363	.3333



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Inadequate Record Keeping	.2500	.4137	.1818	.3333
Others	.3750	.2068	.6363	.3333



## SOME INTER-RELATIONSHIPS

In addition to ascertaining how the quality of financial statements varies by type of government, it is of interest to examine how the various GAAFR standards affect the auditor's opinion, and whether there is any relationship between the type of auditor and the opinion given by the auditor.

Summaries by Audit Opinion

Table 9 shows the proportion of governments which included the various combined statements by the audit opinion they received. For example, of the 71 governmental units that received a qualified audit opinion, only 61, or 86% had included a combined balance sheet. It should be noted that 6 units receiving disclaimer and adverse opinions are not analyzed because of the small sample size. As can be seen from Table 9, governments receiving unqualified and the qualified audit opinions tend to provide various combined statements to the same extent. On the other hand, it is interesting to note that of those receiving unqualified opinions, nearly 11% did not present a combined balance sheet and nearly 25% did not present a combined summary of revenue and expenditures. It is also apparent that several combined statements were provided more often by governments receiving unqualified opinions than those receiving qualified opinions or those found not auditable.

A similar analysis is provided for various data and reports recommended by GAAFR (see Table 10) compared to the type of opinion received. By and large, governments which received unqualified or qualified opinions tended to report to the same extent information recommended by GAAFR. Of the 15 types of other information recommended, there were only 4 statistically significant different proportions of those with unqualified vs. qualified opinions. On the other hand, those governments receiving unqualified opinions

Table 9 Combined Statements Recommended by GAAFR by Audit Opinion  
(Table entry is proportion of respondents)

GAAFR-Combined Statements	Unqualified (62)	Qualified (71)	Not Auditable (29)	Overall (162)
Balance Sheet	.8871 <sup>#</sup>	.8592 <sup>**</sup>	.3793	.7917
Gen. Gov. Revenues	.7419 <sup>#</sup>	.6761 <sup>**</sup>	.4483	.6607
Gen. Gov. Expenditures	.7581 <sup>#</sup>	.6761 <sup>**</sup>	.4483	.6607
Cash Receipts & Disbursements	.4839 <sup>*</sup>	.3099	.4828	.4107
Investments	.5161 <sup>*#</sup>	.2958	.1724	.3631
Long Term Debt	.6774 <sup>#</sup>	.5775 <sup>**</sup>	.3448	.5714

- \* Proportion of unqualified is significantly different from proportion of qualified opinions at 95% confidence level.  
 \*\* Proportion of qualified opinions is significantly different from proportion of not auditable at 95% level.  
 # Proportion of unqualified opinions is significantly different from proportion of not auditable at 95% level.

tended to report more additional information than those governments which were not audited. In only 1 of the 15 governments was the difference in proportions between those receiving unqualified opinions vis-a-vis those not audited not significantly different at the 95% confidence level. Note also that while the first four reports were frequently present by all governments, the remaining reports tended to be presented less than half the time. Finally, note also that of those receiving an unqualified opinion, 18% did not report tax revenue by source, 21% did not report property tax levies, and 42% did not report the ratio of assessed to actual value.

#### Summaries by Type of Auditor

Table 11 shows the percentage of audit opinions given by each type of auditor. For example, out of the 129 governmental units



Table 10 Disclosure of Supplementary Data  
 Recommended by GAAFR by Audit Opinion.  
 (Table entry is proportion of respondents)  
 (See Table 9 for footnote definitions)

Recommended by GAAFR	Unqualified (62)	Qualified (71)	Not Audit (29)	Overall (162)
General Expend- itures by Function	.9677**	.9296 <sup>#</sup>	.7241	.8988
General Revenues by Source	.9839**	.9718	.8966	.9583
Tax Revenues by Source	.8226*,**	.6479	.6552	.7083
Property Tax Levies	.7903**	.6901	.5172	.6964
Assessed/Value Taxable Property	.5806**	.5493	.4138	.5258
Overlapping Tax Rates & Levies	.5161	.3944	.3793	.4405
Special Assessment	.3871**	.4085 <sup>#</sup>	.1714	.3512
Net Bonded Debt/ Assessed Value	.5161*,**	.3239	.2414	.3750
Direct & Over- lapping Debt	.4516**	.4085	.2069	.3810
Annual Bonded Debt Service/Total Expenditures	.4516*,**	.1690	.1034	.2619
Scheduled Revenue Bond Coverage	.5000*,**	.2535	.2759	.3512
Gen. Obligation Debt Service to Maturity	.7258**	.6620 <sup>#</sup>	.3448	.6190
Debt Service to Maturity	.5161**	.4930	.3103	.4702
Schedule Insurance in Force	.4839**	.3803 <sup>#</sup>	.1379	.3750
Salaries- Officials	.4355**	.3803 <sup>#</sup>	.1724	.3512

which were audited by an independent CPA, 53 or 41% received an unqualified opinion. While this table shows that between 40-50% of each auditor type generated an unqualified opinion, the opinions of interest are the qualified and the not auditable. The independently audited governmental units received a qualified opinion 53% of the time, while the state-audited received that opinion only 17% of the time, and those audited by an independent official only received qualified opinions 8% of the time. On the other hand, one third of those audited by State auditors were considered not auditable and 42% of those audited by an independent official were not auditable, as compared to 2% of those audited by an independent CPA. This difference would appear to be too large to be explained by chance. This data may imply that the independent CPA's were less willing to issue a "not auditable" opinion. It may also show that governments with potential audit problems do not choose independent CPA firms to perform their audits.

Table 11 Audit opinion by Auditor type.  
(Table entry is proportion of respondents)

Audit Opinion	Independent CPA (129)	State Auditor (12)	Independent Official (12)	Not Audited (17)
Unqualified	.4109	.5000	.4167	.0000
Qualified	.5271*#	.1667	.0833	.0000
Disclaimer	.0233	.0000	.0000	.0000
Adverse	.0233	.0000	.0833	.0000
Not Auditable	.0233*#	.3333	.4167	1.0000

\* Proportions of independent CPA and State auditor are significantly different at 95% confidence level.

# Proportions of independent CPA and independent official are significantly different from zero at 95% confidence level.



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# Proportions of independent CPA and independent official are significantly different from zero at 95% confidence level.



Table 12 shows the reasons given for the qualified or adverse opinion by auditor type. Because of small numbers for the state auditor and independent officials, the column of interest is the independent CPA. The non-GAAP principles (61%) and the inadequate records (46%) are clearly given most often, with 25% of those also specifying inadequate internal control. It is interesting to note that while 34 of these had inadequate records, only 3 were classified as unauditable.

Table 13 examines the specific reasons for specifying non-GAAP. Here again, inadequate records (33%) and incomplete disclosure (36%) are stated most often.

Table 12 Reason for Qualified or Adverse Opinion by Auditor Type.  
(Table entry is proportion of respondents)

Reason for Qualified or Adverse Opinion	Independent CPA (74)	State Auditor (2)	Independent Official (2)
Non-GAAP	.6081	.5000	1.0000
Inadequate Records	.4595	.5000	.5000
Uncertainties Caused by Litigation	.1081	.5000	.0000
Change in Accounting Principles	.1621	.0000	.5000
Noncompliance with Legal Requirements	.0270	.0000	.0000
Inadequate Internal Control	.2432	.0000	.0000
Other Reasons	.1216	.0000	.0000

Table 13 Reason given for Non-GAAP by Auditor Type.  
(Table entry is proportion of respondents)

Reasons for those Specifying Non- GAAP	Independent CPA (45)	State Auditor (1)	Independent Official (2)
Did not use accrual	.2666	1.0000	1.0000
Incomplete Disclosure	.3555	.0000	.5000
Improper Capitalization	.2666	.0000	.0000
Inadequate Records	.3333	.0000	.5000
Others	.3111	.0000	.0000

#### IMPLICATIONS FOR NEW STANDARDS FOR FINANCIAL REPORTS OF LOCAL GOVERNMENTS

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Without repeating each of our findings, a number of important regularities are worthy of note: first, relatively short-term information tends to be reported by governments. For example, combined balance sheet information was provided more than a majority of the time. However, information about long-term activities such as investments is not provided very frequently. Also, information about current general expenditures by function is provided by better than 85% of local governments, while information on bonded debt/assessed value is provided by no more than 37% of local governments overall.



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With respect to the nature of audit opinions received, only roughly one-third of local governments received an unqualified opinion, and another 30 to 46% received a qualified opinion. Put another way, roughly 22% of local governments received either an opinion with a disclaimer, received an adverse opinion, or were found not auditable. Within this group, virtually all of the opinions involved the not auditable category. Counties were found to be not auditable a higher proportion of the time (28%) than cities (11%). These adverse or qualified opinions were rendered for three reasons most frequently: utilization of non-GAAP principles (65% overall), inadequate records (46%), and inadequate control (23%).

When one compares the type of audit opinion provided with the information provided in the financial statements, it appears that unqualified opinions are being widely rendered even though much information recommended by GAAFR is not being provided. For example, of those units which received an unqualified opinion, more than half did not provide a combined statement of cash receipts and disbursements which was about the same proportion of those found not auditable.

With respect to the type of opinion rendered in relation to the type of auditor utilized, there appears to be some reluctance on the part of the independent CPA's to give not auditable opinions. Only 2.3% of the opinions rendered by independent CPA's were "not auditable" compared to 33% for state auditors, and 42% by an independent official. Independent CPA's were far more likely to render qualified opinions (53%) than either state auditors (17%) or independent officials (8%). It is possible that jurisdictions audited by independent CPA's correct deficiencies during an audit so that ultimately an audit can be performed, or it is possible that the condition of governments' financial records varies with the type of auditor utilized. In any case, the differences found here are quite striking and will receive further scrutiny by the authors in subsequent research.

If we compare the current information being provided on average by local governments in relation to what is currently being recommended, or in relation to that information which a variety of groups, including the Governmental Accounting Research Project of the National Council on Governmental Accounting, is recommending, we must observe some caution. Information for immediate budgetary purposes is generally being provided in aggregate, but information about long-term activities, or information which relates various activities of an average local government so that it may be of analytical and more general interest simply is not being provided. Moreover, based on our information on the audit opinions, there are large numbers of counties, cities, and townships in the United States whose financial statements do not fairly reflect their activities in accordance with GAAP. In turn, these difficulties are due to inadequate control and inadequate record-keeping.

It surely will be desirable in the future for local governments to increasingly inform the broader audience of elected officials and citizens of the fiscal activities of their governments; however, based on our sample, it is difficult to conclude that more complex reporting requirements could be met by the majority of local governments. A very first task would seem to be improvements in the basic financial statements currently being maintained.

Finally, we observe that there may be some difficulties on the part of the auditors in applying current accounting principles and following good practices, irrespective of the underlying condition of a jurisdiction's record-keeping. It is beyond the scope of the data presented here to reach any firm conclusions about this, but our empirical finding that high proportions of governments receiving unqualified opinions did not provide certain basic financial statements is a cause for further study in this area.



## NOTES

1 This chapter was written by Prof. W.D. Haseman of the University of Wisconsin - Milwaukee, and Prof. R.P. Strauss of Carnegie-Mellon University with financial support provided by the NCGA/HUD Governmental Accounting Research Project. The authors wish to thank J. Arthur Leer and Allan R. Drebin for their comments on an earlier draft of this paper.

2 See Section 123., Public Law 92-512.

3 See Section 8, Public Law 94-488. .

4 See Section 9, Public Law 94-488.

5 Local governments from the following states reported directly to the Office of Revenue Sharing: Alabama, Alaska, Arizona, Arkansas, Connecticut, Delaware, Florida, Georgia, Hawaii, Kentucky, Louisiana, Maine, Mississippi, Missouri, Nebraska, New Hampshire, Oklahoma, Pennsylvania, South Carolina, Texas, Utah, Vermont, Wisconsin, and Wyoming. Local governments in other states reported through a state agency.

6 See Federal Register, Vol. 44, No. 205, pp. 60958-60; Vol. 45, No. 195, pp. 66338-43; and Vol. 45, No. 161, pp. 55086-115. Also, see General Accounting Office, Guidelines for Financial and Compliance Audits of Federally Assisted Programs (February 1980).

7 General Accounting Office, Report to the Congress: Revenue Sharing Act Audit Requirements Should be Changed (GGD-76-90); Report to the Congress: More Stringent Revenue Sharing Act Requirements are Upgrading State and Local Government's Audits (GGD-80-35).

8 How Cities Can Improve Their Financial Reporting, Ernst and Whinney, 1979.

9 Governmental Accounting, Auditing and Financial Reporting, MFOA, 1968.

10 Statement 1, Governmental Accounting and Financial Reporting, NCGA, 1979.

11 Throughout the tables below, we test for differences between proportions. Our test statistic,  $z$ , is analogous to a difference between means test and is distributed  $n(0,1)$ :

$$z = \frac{p_1 - p_2}{\sqrt{\hat{s}(1-\hat{s}) \cdot \left( \frac{1}{n_1} + \frac{1}{n_2} \right)}}$$

where  $p_1$  and  $p_2$  are the proportions from separate groups 1 and 2 with  $n_1$  and  $n_2$  observations, and  $s = \frac{n_1 p_1 + n_2 p_2}{n_1 + n_2}$ .

12 See Public Law 94-488, Section 9.