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THESIS

**THE CHARITABLE TRUST MODEL: AN ALTERNATIVE
APPROACH FOR DEPARTMENT OF DEFENSE
ACCOUNTING**

by

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December 2016

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DEPARTMENT OF DEFENSE ACCOUNTING**

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Submitted in partial fulfillment of the
requirements for the degree of

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The purpose of this project is to identify logical weaknesses in the financial statements of the Department of Defense (DOD) and to propose an alternative approach to accounting to supplant the current corporate-style financial management and reporting practices mandated by federal law. First, the researcher identifies the influences, statutes, and organization bodies that form the framework for contemporary federal financial reporting. Second, the researcher identifies the fundamental differences between the private and public sectors and divergent purposes of financial reporting in both domains. Next, the researcher presents evidence from stakeholders, indicating the current corporate-style financial statements are less useful than intended in government administration. The researcher then analyzes how the misapplied logic of private sector accounting creates weakness and inconsistencies in federal reporting. The researcher discusses alternative approaches from accounting literature that recognize the differences between sectors and introduces the trust arrangement. Finally, the trust model is overlaid onto the administration of the DOD and recommended as a more useful accounting system for the agency.

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LIST OF ACRONYMS AND ABBREVIATIONS

AGA	Association of Government Accountants
BAPA	Budget and Accounting Procedures Act
BRAC	base realignment and closure
CIGIE	Council of Inspectors General for Integrity and Efficiency
CFO	chief financial officer
CFO Act	Chief Financial Officer's Act
CFOC	Chief Financial Officers Council
CFR	consolidated financial report
CON 1	<i>Concepts No. 1</i>
DOD	Department of Defense
ERP	enterprise resource planning
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FIAR	Financial Improvement and Audit Readiness
FY	fiscal year
GAAP	generally accepted accounting principles
GAO	Government Accountability Office
GASB	Government Accounting Standards Board
GMRA	Government Management Reform Act
NDAA	National Defense Authorization Act
ND PP&E	national defense property, plant and equipment
NPM	new public management
OMB	Office of Management and Budget
PP&E	property, plant, and equipment
Rep.	Representative
ROI	return of investment
SBR	statement of budgetary resources
SFFAC	statement of federal financial accounting standards concepts
SFFAS	statement of federal financial accounting standards
SNC	statement of net cost
SCNP	statement of changes in net position

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I. INTRODUCTION

Article I, § 9, paragraph 7 of the U.S. Constitution declares, “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of all public Money shall be published from time to time” (U.S. Const. art. I, § 9). This provision represents the basis for federal financial reporting, granting Congress the “power of the purse” and requiring oversight in the form of a regular report detailing the government’s use of public money. In the 200 years since the founders established this nation, various statutes have subsequently mandated additional accounting and reporting requirements to meet the needs of each succeeding era. Concerns regarding the government’s accountability and stewardship of public resources and assets continue to present day.

A. BACKGROUND

In the 1980s, Congress turned to corporate management and reporting practices to facilitate greater accountability and an improved understanding of the federal government’s financial position. The Chief Financial Officers (CFO) Act of 1990, as amended by the Government Management Reform Act (GMRA) of 1994, mandated preparation of annual financial statement analogous to the private sector for use in government administration. Passage of these statutes and other related legislation represents the subordination of the federal government to the same financial management and reporting requirements it imposed on the private sector.

To date, 23 of the 24 major federal government agencies, except the Department of Defense (DOD), have achieved CFO Act compliance and received audit opinions other than disclaimed. DOD has not been able to produce auditable financial statements and remains under congressional scrutiny to comply with legislated mandates. If the fiscal year (FY) 2017 financial statements are not auditable, the deadline established by Congress in the National Defense

Authorization Act (NDAA) of 2010, DOD will face compulsory budgetary reductions and reduced autonomy and jurisdiction to manage its internal financial affairs. DOD's inability to achieve an unqualified opinion creates accountability issues that extend beyond the agency by making an audit of the U.S. consolidated financial statements challenging.

The DOD has invested billions of dollars into its CFO compliance activities. The 2016 *Financial Improvement and Audit Readiness (FIAR) Plan Status Report*, published by the Office of the Undersecretary of Defense (Comptroller)/Chief Financial Officer, shows the DOD spent more than \$500 million in FY2015 and intends to spend another \$3.34 billion over the next five years (DOD, 2015). These figures do not include the billions more the DOD spent on multiple enterprise resource planning (ERP) systems to modernize its financial processes.

Production of financial statements is a fundamental component of financial accounting. The purpose of financial accounting is to periodically report information about the performance, results of operations, financial well-being, and cash flows of a business to external parties through financial statements. The consumers of financial statements apply this information to make economic decisions regarding the allocation of resources. While the utility of corporate-style financial statements in the private sector is undisputed and constitutes the basis for federal financial reporting statutes, there is debate about their usefulness and utility in public administration.

The private and public sectors are fundamentally different in their organizational purposes. Subsequently, the primary objectives and users of financial statements are not the same for both domains. Corporate investors and creditors are located external to a private organization and principally concerned with the financial position and solvency of the entity. Federal statement users—citizens, Congress, executives, program managers—reside both internal and external to government and are chiefly concerned with how responsibly the federal government manages public resources. Business sector enterprises

operate on a for-profit basis and are financed entirely through private investment. Governments are financed from non-voluntary taxation and provide social benefits and public goods on a nondiscriminatory and non-rival basis to all citizens. In spite of these differences, both sectors use a common accounting approach. Is it possible for common financial statement content to satisfactorily meet the needs of users with divergent objectives?

Research indicates corporate-style financial statements do not adequately meet the needs of users in government. This thesis argues the federal government is so different from that of the private sector that accounting techniques utilized in the private sector, as prescribed by the generally accepted accounting principles (GAAP), are not appropriate for use by public administration. Federal performance is service driven, based on the needs of the nation as perceived by its citizens, in contrast to private business which is profit motivated and subjected to the needs of private stockholders and the pressures of financial markets. The vast majority of the government's programs are social in nature and the current financial reporting practices offer no real means to assess program efficiencies or determine a "bottom line" by which to assess federal performance. This is especially true of DOD.

DOD is a heavily capital intensive organization chartered by the federal government to provide national defense, an outcome that is difficult to define and defies measurement. It is not possible to ascertain with any degree of precision the national defense provided and appropriately match it to the expenses incurred. Defense concepts such as security and deterrence are impossible to measure according to financial models. Therefore, national defense should not be considered an end in itself, but rather an instrument to achieve other purposes (e.g., national policy) for which private sector financial reporting practices may not be suitable or appropriate to measure or evaluate.

B. SCOPE AND OBJECTIVE

This thesis identifies logical weaknesses in the financial statements of the DOD and argues the DOD's unique charter to provide national defense warrants a new approach to best account for the assets listed on its balance sheet. However, this thesis is limited to proposing an alternate model for accounting and preparation of DOD financial statements. It does not recommend a new model for management of the agency. While this thesis generates its argument from data accrued across the full spectrum of federal government financial management and reporting practices, entities, and stakeholders, the recommended approach to financial reporting is limited solely to DOD.

The primary objective of this thesis is to recommend an alternate approach to current DOD financial management and reporting practices. The charitable trust model of accounting seems to be a more logical and useful approach to financial management and reporting for the DOD than that of the private sector. This thesis identifies logical faults in the rationale underpinning the use of private sector financial statements as mandated by the CFO Act to financial management of the DOD. Specific attention is given to the differences that distinguish the private and public domains as well as the divergent needs of users of financial statements in both sectors. This thesis explains the purpose, function, and utility of the charitable trust model of accounting and the merits of its application to DOD financial management and shows reporting how it constitutes a better model for reporting and linking both financial and non-financial information to stakeholders.

C. METHODOLOGY

The thesis begins by identifying the current statutes and regulatory bodies governing federal financial and briefly explains the rationale behind implementation of corporate-style reporting practices. This thesis discusses various aspects of the private and public sectors and their respective financial reporting GAAP, reporting objectives and users of financial statements. The

fundamental differences between the two sectors are explained in detail specifically highlighting the unique nature of the DOD. Taking these differences into account, this thesis identifies the logical weaknesses inherent to the government's financial statements and validates this with evidence collected from the relevant stakeholders. The thesis then introduces several alternative approaches to government accounting that address the weaknesses. Finally, the thesis applies a new model to financial reporting in the DOD.

The researcher collected data through review of materials available online in government agency websites, current periodical literature, and prior research. The researcher obtained the majority of government documentation from the Office of Management and Budget, the Government Accounting Office, Financial Accounting Standards Board, Federal Accounting Standards Advisory Board, Government Accounting Standards Board, and the Department of Defense.

D. ORGANIZATION

This thesis is organized into seven chapters. Following the introduction and background information in Chapter I, Chapter II introduces the statutes and current authorities governing federal financial reporting. The role of the Federal Accounting Standards Advisory Board, the basis for government implementation of corporate-style financial statements, and federal financial reporting deliverables are explained.

Chapter III discusses in detail the differences between the public and private sectors with regard to organizational purpose, financial statement users groups, and objects and sources of revenue. Additionally, the chapter introduces the theme that the government's financial statements are less useful than intended. The chapter also presents a variety of evidence from across the full spectrum of federal stakeholders to support this assertion.

Chapter IV discusses how the logic of corporate-style financial statements does not translate well to government administration. The chapter identifies the logical faults inherent to the structure and purpose of the statements as well

illustrating inconsistencies between public and private accounting practices. It concludes by presenting two alternative approaches to government accounting.

Chapter V introduces the concept of the trust arrangement and outlines its objective, components and administration, emphasizing how a trust links property to a specific purpose. It also outlines the duties of a trustee in detail. In addition, the chapter explains the distinction between private and charitable trusts and provides examples of both types. The chapter concludes by explaining the requirements of trust accounting, going into detail regarding not-for-profit financial reporting.

Chapter VI applies the charitable trust model to the federal government's management of DOD assets. This chapter explains in detail the roles of federal stakeholders under a trust administration and how trust property is put into trust and utilized to achieve a specific purpose. The chapter concludes with a detailed analysis of the benefits and advantages of trust. Finally, Chapter VII contains the recommendations and limitations of the thesis.

E. BENEFITS OF THE THESIS

This thesis benefits the users of federal financial statements, especially those stakeholders with an interest in financial information related to the DOD. By highlighting the logical weaknesses inherent to federal financial statements this thesis serves as a catalyst for future discussion of more useful approaches to accounting for the DOD.

II. THE BASIS FOR CONTEMPORARY FEDERAL REPORTING

To understand the weaknesses inherent to the federal government's financial statements, it is imperative to examine and understand recent history, key statutes, and the regulatory agencies that mandate how the government presents its financial information. This chapter opens by discussing the two most influential pieces of financial management reform legislation that constitute the foundation of contemporary reporting. The chapter then discusses the establishment and purpose of the Federal Accounting Standards Advisory Board (FASAB) and the influence of new public management (NPM) on contemporary federal reporting practices. The chapter concludes by listing the various financial statements and reports mandated by federal statutes.

A. THE CHIEF FINANCIAL OFFICERS ACT OF 1990

The Chief Financial Officers Act (CFO Act) of 1990 represents the most comprehensive federal financial management reform since passage of the Budget and Accounting Procedures Act (BAPA) of 1950 and the Budget and Accounting Act of 1921 before it. Provisions of the CFO Act adopted proven private sector accounting practices and established a centralized financial management leadership structure and mandated production of agency-level financial statements. To facilitate stewardship and accountability, the statute established influential chief financial officer positions within executive agencies. As stated in § 102(b), the purpose of the CFO Act is:

- Bring more effective general and financial management practices to the Federal Government through statutory provisions which would establish in the Office of Management and Budget a Deputy Director for Management, establish an Office of Federal Financial Management headed by a Controller, and designate a Chief Financial Officer in each executive department and in each major executive agency in the Federal Government.
- Provide for improvement, in each agency of the Federal Government, of systems of accounting, financial

management, and internal controls to assure the issuance of reliable financial information and to deter fraud, waste, and abuse of Government resources.

- Provide for the production of complete, reliable, timely, and consistent financial information for use by the executive branch of the Government and the Congress in the financing, management, and evaluation of Federal programs. (CFO Act, 1990)

Preparation of auditable financial statements was an integral component of the new legislation intended to facilitate the production of “complete, reliable, timely, and consistent” information related to agency operations (CFO Act, 1990). This information—paralleling practices within the private sector—would enable key federal government stakeholders to evaluate the performance of programs and activities in a more effective and efficient manner. The statute designated 10 executive branch agencies to produce audited financial statements in the same manner prescribed for business enterprises. The CFO agencies, as they came to be known, included the Department of Agriculture, Department of Labor, Veterans Affairs, General Services Administration, Social Security Administration, Department of Housing and Urban Development, Army, Air Force, Internal Revenue Service, and United States Customs Service (CFO Act, 1990). A GAO report published shortly after the law went into effect remarked, “Most importantly, the act requires that financial statements be prepared and audited...Together, these features of the CFO Act will improve the reliability and usefulness of such Agency financial information” (Government Accountability Office [GAO], 1991, p. 14).

B. THE GOVERNMENT MANAGEMENT REFORM ACT OF 1994

Four years later lawmakers passed a second piece of reform legislation, far more comprehensive in scope, which affected the entire the federal government. The mandate to produce agency-level financial statements introduced by the CFO Act was further codified by passage of the Government Management Reform Act (GMRA) in 1994. GMRA significantly expanded the CFO Act’s statutory authorities to include all 23 major agencies within the federal

government. This has since increased to 24 when the Department of Homeland Security was established in 2002.

With GMRA, the federal government fully committed to implementing private sector financial reporting practices and accepted corporate-style financial statements as its performance measure of choice. The statute required “all CFO agencies to prepare and submit audited financial statements for the previous year for all accounts and activities to the director of the Office of Management and Budget [OMB]” beginning with the FY 1996 statements” (Hatch, 2013, p. 7). GMRA further mandates the secretary of the Treasury to prepare and submit an audited government-wide financial statement for the preceding fiscal year to the president and Congress. Finally, the GMRA directed GAO to audit the financial statements before they are submitted. In accordance with GMRA requirements, Title 31 of the United States Code was amended to read as follows:

Sec. 3515. Financial statements of agencies

(a)(1) Except as provided in subsection (e), not later than March 1 of 2003 and each year thereafter, the head of each covered executive agency shall prepare and submit to the Congress and the Director of the Office of Management and Budget an audited financial statement for the preceding fiscal year, covering all accounts and associated activities of each office, bureau, and activity of the agency.

(b) Each audited financial statement of a covered executive agency under this section shall reflect

(1) the overall financial position of the offices, bureaus, and activities covered by the statement, including assets and liabilities thereof; and

(2) results of operations of those offices, bureaus, and activities (31 U.S.C. § 3515)

Sec. 3521. Audits by Agencies

(e) Each financial statement prepared under section 3515 by an agency shall be audited in accordance with applicable generally accepted government auditing standards. (31 U.S.C. § 3521)

The CFO Act and GMRA were passed into law to increase federal accountability through financial management reform. The requirement to produce auditable financial statements on an annual basis was viewed as a significant stride toward facilitating stewardship and accountability within executive branch agencies. Financial statements supply the requisite information to make informed decisions regarding policy and management of public resources. While the CFO Act initially limited the requirement to a select group of agencies, GMRA expanded the requirement to include the majority of federal government entities as well as mandating a consolidated government-wide financial report. The federal government was now subordinated to private sector accounting practices.

C. THE ROLE OF THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The CFO Act itself did not specify an exact format for the new financial statements and reports. Instead, the statute mandated the director of OMB “prescribe the form and content of the financial statements of executive agencies under this section, consistent with applicable accounting principles, standards, and requirements” (CFO Act, 1990). To comply with this provision, OMB, the Secretary of the Treasury, and the comptroller general agreed to a joint approach and, in 1990, established the Federal Accounting Standards Advisory Board (FASAB). The new organization was charged by its sponsors to develop the federal government’s generally accepted accounting principles (GAAP) to facilitate preparation of the newly mandated financial statements. Formation of the advisory committee was landmark because, as stated on the FASAB webpage, “[f]or the first time, the legislative and executive branches agreed to work together in an agreed framework, with an open, public process, to determine the accounting standards that federal agencies should follow” (FASAB, n.d.).

FASAB’s mission statement is as follows

The FASAB serves the public interest by improving federal financial reporting through issuing federal financial accounting standards

and providing guidance after considering the needs of external and internal users of federal financial information. (Federal Accounting Standards Advisory Board [FASAB], 2012)

FASAB's function within the federal government mirrors the role of Governmental Accounting Standards Board (GASB), created in 1984, to establish accounting and financial reporting standards for U.S. state and local governments and government not-for-profit organizations as well as the Financial Accounting Standards Board (FASB). The FASB was created in 1973 to establish financial accounting and reporting standards for public and private companies and non-profit organizations.

The nine-person FASAB is composed of both federal and non-governmental representatives. The three federal representatives are sourced from the sponsor agencies (OMB, Treasury, GAO) while the six non-government affiliated members are selected from within the private sector accounting, auditing, finance, and academic communities following a confirmation process. The non-governmental members ensure access to the most current business sector financial management practices—the same practices on which the CFO Act and GMRA legislation are based—and their supermajority representation, as claimed by FASAB, serves to enhance the board's independence (FASAB, 2012). While purporting to adhere to an independent and objective decision making process, the FASAB was clearly developed to ensure congruence between the corporate world and federal government accounting standards.

To accomplish its mission, FASAB leverages its diverse composition and utilizes a comprehensive and objective standards-setting process. The board actively solicits stakeholder participation and conducts a thorough cost benefit analysis to determine impacts of its recommendations to financial statement preparers and users. FASAB works diligently to ensure its guidance is promulgated and readily available to practitioners and auditors. Through its participation in education efforts and robust communication with stakeholders,

the board strives to ensure universal understanding and adherence of standards within the accounting community.

In 1993, OMB published Circular A-134, *Financial Accounting Principles and Standards*, to formalize the accounting standards approval process between FASAB and the principle agencies (OMB, 1993). As per Circular A-134, the board is instructed to forward its recommended accounting standards, principles or concepts to the director of OMB for review. Should the director concur with the board's recommendation, the director issues a statement of federal financial accounting standards (SFFAS) (OMB, 1993). SFFASs are considered GAAP for federal agencies and are the authoritative reference for preparers and auditors of annual financial statements (OMB, 1993).

In summary, the FASAB was established as a financial management and accounting advisory entity as a direct result of the CFO Act. The composition of the board is deliberately structured to incorporate non-federal members to provide private sector subject matter expertise and enable the federal government to remain abreast of business sector best practices. Approval of FASAB's recommended accounting statements, principles or concepts resides with the director of OMB and are published as SFFAS. SFFASs form the basis of federal financial reporting.

D. NEW PUBLIC MANAGEMENT

FASAB recommended a financial statement reporting format congruent with the private sector. Advocates for corporate-style financial statements based their arguments primarily upon experiences drawn from business enterprises. The advent of the New Public Management (NPM) movement in the late 1970s in the United Kingdom under the Thatcher administration significantly influenced the decision to adopt private sector financial management practices (Kajimbwa, 2013). The NPM paradigm is grounded in the belief that private sector management techniques will produce greater efficiency and effectiveness in public administration. NPM represented the attempt to shift away from

bureaucratic administration to business-like professional management in government. In essence, NPM advocated running government like a business.

The theory underlying passage of the CFO Act and GMRA is that if federal government agencies are required to implement private sector financial management and reporting systems and produce auditable corporate-style financial statements, then the performance of agency operations will improve over time. Proponents of NPM claim corporate-style accounting and reporting provide decision makers and managers with more useful and relevant information beyond what traditional budgetary accounting affords (Hood, 1991).

NPM reforms sought to redefine the relationship between citizen and government into a business-like interaction between customer and service provider. To provide citizens with quality services in return for monetary resources received in the form of taxation, NPM paradigm stresses the importance of accrual based accounting, a greater emphasis on government accountability, and better management of public assets. The preparation of financial statements and subsequent analysis of this data are the principle means to assess and improve the performance of government agencies.

E. FINANCIAL STATEMENT DELIVERABLES

Corporate-style financial statements are designed to provide users with information regarding the financial well-being of an entity over a definitive span of time to enable informed decision making. Therefore, the format and presentation of the financial data is of great importance. As stated in SFFAC 1, the government's financial statements present historical information over the course of a fiscal year detailing three principal aspects: (1) what the federal government owns and owes, (2) what revenue was generated and what funds were expended to conduct government operations, and (3) the relationship between the government's operating costs, budget deficit and changes in its cash position during the year (FASAB, 1993).

CFO agencies must produce financial statements in compliance with OMB Circular No. A-136, *Financial Reporting Requirements*. The most recent revision states

This Circular establishes a central point of reference for all Federal financial reporting guidance for Executive Branch departments, agencies, and entities required to submit audited financial statements... under the Chief Financial Officers Act of 1990, as amended. (OMB, 2016)

Circular A-136 provides definitive guidance on the composition of the government's financial statements. As per the guidance, the annual financial statements of a reporting entity within the federal government will consist of

- A. Management's discussion and analysis;
- B. (2) Basic statements and related notes;
- C. (3) Required supplementary stewardship information (RSSI), if applicable; and
- D. (4) Required supplementary information (RSI), if applicable (OMB, 2016).

Circular A-136 further clarifies the basic statements are comprised of the following documents

- A. Balance Sheet;
- B. Statement of Net Cost (SNC);
- C. Statement of Changes in Net Position (SCNP);
- D. Statement of Budgetary Resources (SBR);
- E. Statement of Custodial Activity (SCA), when applicable;
- F. Statement of Social Insurance (SOSI), when applicable;
- G. Statement of Changes in Social Insurance Amounts (SCSIA), when applicable; and
- H. Related note disclosures. (OMB, 2016)

The basic annual financial statements required of CFO agencies very closely resemble the annual report to shareholders required of private sector business enterprises, albeit with subtle differences regarding naming convention.

The government balance sheet, SNC, SCNP, and SBR have direct parallels with the corporate balance sheet, income statement, statement of changes in equity, and statement of cash flows. Both government and private sector financial statements and reports are designed to provide a comprehensive overview of the previous year's operations and current financial position. The retrospective aspect of financial statements, however, is significant. The statements are based on historical data—the statements are essentially backward looking and offer limited utility for future analysis.

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III. DIFFERENT SECTORS, COMMON FINANCIAL REPORTING

The purpose of this chapter is to illustrate how governments and businesses are fundamentally different and how they possess divergent financial reporting requirements. It is meant to reinforce the question of whether common corporate-based financial reporting standards can meet the financial management needs of both types of organizations. The chapter begins by discussing the objectives and users of federal financial statements and reports. Then, the chapter includes a comparison of federal objectives and users to their equivalents in the private sector. The chapter closes by summarizing the key differences between the public and private sector.

A. FEDERAL REPORTING OBJECTIVES AND USERS

The overarching tenets of federal financial reporting are contained within Statement of Federal Financial Accounting Standards Concepts (SFFAC) 1, titled *Objectives of Federal Financial Reporting* (FASAB, 1993). The publication explains the chief objectives, identifies the primary financial statement users and explains their respective needs. SFFAC 1 provides the basis for future statements from FASAB and ensures the board's recommendations are developed within the context of government administration (FASAB, 1993). SFFAC 1 states financial statements and reports should help the government to “(1) demonstrate its accountability to internal and external users of federal financial reports, (2) provide useful information to internal and external users of federal financial reports, and (3) help internal users of financial information improve the government's management” (FASAB, 1993, para 3). According to FASAB, “financial reporting” may be defined as

the process of recording, reporting, and interpreting, in terms of money, an entity's financial transactions and events with economic consequences for the entity. Reporting in the federal government also deals with nonfinancial information about service efforts and accomplishments of the government, i.e., the inputs of resources used by the government, the outputs of goods and services

provided by the government, the outcomes and impacts of governmental programs, and the relationships among these elements. (FASAB, 1993)

As Pallot explains,

[A] distinguishing feature in the development of government accounting to date has been the underlying principal of *democratic control over the use funds*, made critical by the coercive ability of governments to raise money through taxation (1992).

The non-voluntary nature of the relationship between the providers and users of finance in government also makes accountability particularly important in the public sector (1992).

The non-reciprocal aspect of taxation amplifies the need for government accountability as citizens may receive nothing directly in return for their tax dollars. Citizens are not taxed based on government services and social benefits they request, but typically according to their personal wealth and income. The unique aspects of government administration are important and SFFAC 1 addresses these issues directly:

The federal government derives its just powers from consent of the governed. It therefore has a special responsibility to report on its actions and the results of those actions. These reports must accurately reflect the distinctive nature of the federal government and must provide information useful to the citizens, their elected representatives, federal executives, and program managers. (FASAB, 1993, para 8)

To effectively communicate information to users, SFFAC 1 stresses six qualitative characteristics that financial information must possess: reliability, relevance, consistency, understandability, comparability, and timeliness. Information contained within financial reports must possess these characteristics to be useful to the intended audience. Reliability infers the financial data is free of errors and bias, and relevance implies all financial information required for decision making is present. Consistency requires the same methods be utilized to prepare statements from period to period, while understandability infers financial information should be comprehensible by users possessing a

reasonable knowledge of business and financial practices. Comparability requires the financial information to be prepared in a similar manner across periods and across agencies. Finally, timeliness requires the issuance of statements and disclosure of financial information within a timeframe that maintains its relevance and enables users to make informed decisions.

Federal financial statement users are most interested in information regarding “budgetary integrity, operating performance, stewardship, and systems and control” to help them assess how responsibly the government is handling public resources (FASAB, 1993, para 11). SFFAC 1 explains information regarding budgetary integrity should assist the user in assessing how effectively the government expended public funds and if these expenditures were executed within the constraints of fiscal law and legal authorities (FASAB, 1993). Operating performance information helps the user determine the costs of government programs and activities and details their respective service, efforts, and accomplishments. Additionally, operating performance information relates how well the government is managing its assets and liabilities. Financial information concerning stewardship focuses on how well the government is managing public resources and whether these actions have improved or deteriorated the nation’s financial well-being. Finally, information related to systems and controls assists users in determining if the financial management, reporting, and management controls are sufficient to ensure compliance with budgetary and fiscal law.

SFFAC 1 identifies four principal groups of users form the audience for federal financial reports: Congress, the president, agency heads, program managers, and citizens (FASAB, 1993). As these stakeholders are both internal and external to the government, federal financial reports are useful to them for different reasons. Consequently, the reports may convey information that differs in relevance to respective stakeholders.

- Congress may use financial reports to conduct oversight of federal government programs and policies, consider policy alternatives, make decisions on the financing and execution of programs, monitor the effect of governmental financial

commitments on the economy, and address persistent, long-standing accountability problems.

- The president and agency heads may use financial information to evaluate program performance, make program reauthorization decisions, and provide Congress with the resources necessary to perform its oversight function.
- Program managers may use financial information to ensure that resources are allocated properly, detect waste and inefficiency in program operations, and provide information that enables Congress, the President, and agency heads to monitor programs and activities.
- Citizens may use financial information to evaluate whether their elected and appointed representatives are responsible stewards of the public purse and gauge whether “the government is functioning economically, efficiently, and effectively” (Hatch, 2013).

While the user groups have differing needs, stewardship and accountability are the central themes that provide the basis of federal financial reporting. As stated by Hatch, “[r]esponsible stewardship of public money is integral to governmental accountability, and federal financial reports supply information that links stewardship to accountability” (Hatch, 2013, p.1).

While the emphasis of financial reporting is focused squarely on quantitative data, nonfinancial information contained within the reports holds importance. “Reporting in the federal government also deals with nonfinancial information about service efforts and accomplishments of the government, i.e., the inputs of resources used by the government, the outputs of goods and services provided by the government, the outcomes and impacts of governmental programs, and the relationships among these elements” (FASAB, 1993, para 22). In many regards nonfinancial data is the only way for the federal government to convey how effectively it provides public goods and social benefits to its citizens. The results of these services cannot be valued monetarily and require other nonfinancial measures to adequately convey their meaning.

Paralleling this line of thought, FASAB points out there are limits to the usefulness of financial data alone. “Financial reporting is not the only source of information to support decision-making and accountability. Neither can financial reporting, by itself, ensure that the government operates as it should” (FASAB, 1993, para 106). This comment is significant in that it highlights a major weakness inherent to financial reporting, namely their inability to adequately convey qualitative nonfinancial information that may be of significant value and importance to the user.

A central question of this thesis is, “Do federal financial reporting practices adequately address the needs of users?” In many regard, the current reporting construct falls short of achieving FASAB’s objectives. The CFO agencies comprise 24 separate entities, each chartered with a unique mission. The current financial reporting format, which is heavily based on financial data, does not possess the flexibility to address this reality. While 23 of 24 CFO agencies have produced auditable financial statements, the usefulness and utility of the statements is questionable. A “clean” audit opinion simply implies the entity was auditable, but speaks little to the information contained within the reports or if the needs of the statement users were satisfied.

Evidence indicates the current reporting formats do not meet FASAB’s goal of producing financial information that is useful to its intended audience (Brook, 2010, Chan, 2003, Smith & Chen, 2006). While critics of DOD’s inability to produce auditable financial statements point to internal failings within the organization, given the time and resources committed to CFO compliance, it may be time to rethink the accounting approach. The current financial statement design is based upon the needs of external users in a for-profit environment and not suited to addressing the concerns of internal users in public administration. Additionally, corporate-style financial statements provide stakeholders with limited nonfinancial data to measure the efficiency of programs and activities and identify waste.

B. FOR PROFIT SECTOR ACCOUNTING

The private sector fundamentally differs from the public sector. “Business enterprises operate in private sector markets wherein all decisions about the provision of goods and services by firms and their purchase by customers are private and individual decisions.” (Barton, 2005) The private sector is driven by the profit motive—the incentive for commercial entities is to sell products or services to generate a profit for their investor shareholders. Private markets are competitive in nature and firms must contend with rivals for market share. Potential customers are free to choose where they will take their business and which products and services they will purchase. Business sector operations and the exchanges between firms and customers are entirely private in nature. To remain solvent, a commercial entity must generate a sufficient internal rate of return to finance its operations. It must sell its products and services at prices sufficient to recoup all costs while simultaneously rewarding shareholders. It is paramount for private sector firms to demonstrate a sound financial position to potential creditors and investors—the creditworthiness of a business enterprise is pivotal to borrowing money when necessary.

Business enterprises are profit centers. They are created for this singular purpose and private sector financial management and reporting practices are specifically designed to reflect this goal. Corporate-style financial statements supply information detailing the revenues and expenses generated from a firm’s operations. Business enterprises generally require financial management systems based on comprehensive accrual-based accounting for these purposes. Therefore, private sector financial reporting is intended for use in a for-profit environment to enable statement users to make informed decisions for the purpose of making money.

The FASB is an independent seven-member board that is recognized as the authoritative standard setting body for establishing GAAP in the private sector. *Statement of Financial Accounting Concepts No. 1: Objectives of Financial Reporting by Business Enterprises* (CON 1), is analogous in content to

FASAB's SFFAC 1 for government reporting, and explains the objectives and users of private sector financial reporting (FASB, 1978). Corporate financial reporting is tailored to address the requirements of stakeholders external to the firm who lack authority and placement to access financial data and must rely on management to communicate to them. Much like the FASAB, the FASB employs a comprehensive approach to studying issues and objectively considers the views of stakeholders during its standards-setting process.

Unlike SFFAS 1, however, CON 1 does not purport that an objective of corporate financial accounting is to provide assurances to statement users that resources are allocated properly or that entity operations are efficient. It is imperative to note that private sector financial statement users must do their own "evaluating, estimating, predicting, assessing, confirming, changing, and rejecting of the financial data" (FASB, 1978, p. 6). This is a critical difference between private and public sector financial reporting. Whereas it is incumbent upon the federal government to demonstrate its accountability, business enterprises must simply present the required financial information and the onus (i.e., risk) is placed squarely on users to interpret the meaning of the data. CON 1 states the objectives of private sector financial reporting are as follows:

- Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.
- Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest in the proceeds from the sale, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.

- Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events, and circumstances that change its resources and claims to those resources. (FASB, 1978)

Corporate-style financial statements and reporting are designed primarily to convey information about earnings and components. It is generally recognized that accrual-based accounting affords a more accurate indication of a business enterprise's potential to generate future cash flows as compared to cash basis accounting. While financial information is the most important aspect, the effectiveness of management's stewardship is also important. Corporate-style financial reporting should provide statement users with information that enables assessment of the entity's financial performance and shows how effectively management executed its stewardship responsibility to shareholders.

Private sector financial reporting is designed to furnish external users with necessary information to "make economic decisions on their relationships to and knowledge about business enterprises" (FASB, 1978). Given the profit motive constitutes the primary driver within the business sector, users of financial statement information are generally interested in an entity's ability to generate positive cash flows. Financial statement information is central to the decision of creditors and investors to provide capital to a firm. Stakeholders invest into business enterprises with the expectation to receive, in return, sufficient cash to justify their investment. It is left to the users of private sector financial statements to render their own opinions of what the information means.

C. DIFFERENCES BETWEEN THE SECTORS

Governments exist to provide for the well-being of citizens through public services and social benefits administered in accordance with law and policy goals. Many of these services and benefits are provided indiscriminately to the population in a non-rival and non-exclusive manner. In contrast, business enterprises focus on generating cash flows and choose to interact exclusively with those elements of society that allow them to generate a sufficient return on

investment (ROI) for their shareholder owners. ROI is not a goal for public sector entities, so they must develop other measures, which may include nonfinancial information to report their accomplishments. Governmental agencies exist to fulfill their charter—government function—and the key metric for government is not financial in nature, but rather mission success.

Business sector key performance indicators derived from corporate-style financial statements such as, earnings per share, return on assets and net profit, have no relevance in public administration. Instead, governments seek to provide services and benefits to its citizens as efficiently, effectively, economically, and sustainably as possible. A government's financial reports should "give stakeholders the information necessary to make assessments and decisions relevant to their interests in the government's accomplishments of its objectives" (GASB, 2013, p. 4). Historically, the focus of private sector financial reporting has dealt primarily with earnings and its components, while placing minimal emphasis on nonfinancial measures of performance. Whether the corporate-style financial statements mandated by the CFO Act and GMRA, which are designed to measure profitability and financial position, constitute the most effective or logical approach to government accounting is questionable.

Business enterprises and governments clearly differ. The private sector's focus is exclusively on profitability while public sector entities are judged on effective and efficient delivery of government services and stewardship of public resources. In spite of the substantial organizational differences, FASAB claims corporate-style financial statements provide sufficient information to meet the needs of all stakeholders, internal and external, in government administration. This assertion is at odds with Chan (2003), GASB (2006), Barton (1999, 2005), Flury and Shedler (2006), Stanton (1997), and Biondi (2014) who cumulatively arrive at a similar conclusion: the public and private sectors are fundamentally different and, therefore, the corporate-style reporting model is not entirely applicable to government administration.

D. THE FINANCIAL STATEMENTS ARE LESS USEFUL THAN INTENDED

The last 25 years have shown the transition to corporate-style financial statements has been difficult for the federal government. The financial reporting model mandated by the CFO Act and GMRA was originally developed for measuring net income and profitability of business enterprises; however, public sector agencies and their assets are fundamentally differentiated from the private sector by their not-for-profit (NFP) purpose. Despite the global wave of NPM-inspired public sector accounting reforms, there has been no consensus within the accounting community as to whether private sector GAAP is effective or even appropriate. As related in the following passages, federal government stakeholders' reflections present an unambiguous assessment that corporate-style financial statements are not as beneficial as anticipated.

As early as 1997, a GAO report recognized there were limits to the utility of financial data in government administration. While enumerating the positives associated with CFO Act mandated corporate-style financial statements, the report also remarked, "[The] financial data alone do not provide hard and fast answers. Policy decisions deserve many considerations" (GAO, 1997).

The format of federal financial statements is difficult to interpret and use. The Association of Government Accountants (AGA) conducted a survey of 239 federal financial management decision makers in 2008 and discovered most "agree that the way the Federal Government prepares, presents and audits annual financial statements is broken." Furthermore, the majority of survey participants believed, "the current financial reporting model costs too much and delivers little useful information to government decision makers" (Association of Government Accountants [AGA], 2008).

To explain why that is the case, the AGA report notes that almost all of the 120 senior executives interviewed—representing 70 departments, departmental agencies, and independent entities and commissions—expressed the view that "very little of the information in federal financial reports (in their current private sector-based

form) is relevant to government decision making. (AGA, 2008, as quoted in Hanks, 2009)

Perhaps even more troubling, the report noted “few people actually read federal financial statements, much less use them for making decisions” (AGA, 2008).

Steinhoff and Dacey articulate the need to reevaluate the federal financial model and “recognize the unique needs of the federal government” (2008, p. 14). They further question the utility of corporate reporting statements and if the balance sheet can “capture the full range of the government’s assets and liabilities in a way that is meaningful” (Steinhoff & Dacey, p. 14). From their perspective (as federal government financial management practitioners), “some agencies continue to spend far too much time and money pulling together financial data to prepare financial statements because information systems and processes are not designed to work together” (Steinhoff & Dacey, p. 16). The statements from these practitioners—federal accounting practitioners and recognized subject matter experts—present an unmistakable assessment that government and business reporting are not congruent and that business reporting must, at a minimum, be significantly altered to achieve effective results in public administration.

The government’s financial reporting model has presented such problems to users that in April 2010 FASAB established a task force to investigate the difficulties—two decades since the CFO Act was passed into law. The objective of the task force “was to increase users’ access to and understanding and use of financial information in the Consolidated Financial Report of the federal government, while avoiding costly requirements that do not add value” (FASAB, 2010). In its report to FASAB, ironically, task force members themselves reported experiencing difficulty navigating the government-wide financial report! The task force recommended the government report “program performance measures and accomplishments of the federal government” (FASAB, 2010). The implied meaning of this recommendation being nonfinancial information was viewed of

equal if not greater importance to assess the performance and accomplishments of the government—financial data alone did not provide sufficient information to base an assessment.

FASAB undertook a series of user needs studies targeting citizens, Congress, and executives to gain a better perspective of the effectiveness of financial statements with the intended audience. The studies showed federal executives and managers and citizens could not easily understand the information presented in the financial reports. A common response among study participants was that due to the technical nature of the reports, many believed they were intended for accountants and economists. One study stated,

Leaders we interviewed noted that financial statements and reports are somewhat difficult to understand and not timely to be useful. Some noted that financial reports are designed for those with financial expertise, but that they really need the information in “layman” terms. (FASAB, 2010)

A 2011 report prepared by the CFO Council (CFOC) and Council of Inspectors General for Integrity and Efficiency (CIGIE) undertaken to “present lessons learned from the CFO [Act] and any legislative and regulatory compliance framework changes needed to Federal financial management—all in the interest of optimizing Federal agency efforts in financial reporting and internal controls” revealed analysis of federal financial statements requires specialized knowledge and “many believe there is limited demand for this information outside of government” (Chief Financial Officers Council, and the Council of the Inspectors General on Integrity and Efficiency [CFOC & CIGIE], 2011). Additionally, the report stated “efforts should increase to make financial information more relevant to all of its stakeholders, including decision-makers, program managers, and the public” (CFOC & CIGIE, 2011). Listed among the report’s recommendations was a call to “evolve the financial model” for improved accountability. The significance of this recommendation is substantial in that 20 years after the CFO Act was passed into law, the federal financial reporting model was still not producing the intended results.

Legislators have addressed the lack of utility and useful information in financial reports. In a 2011 House Subcommittee on Government Organization, Efficiency, and Financial Management hearing, Representative Edolphus Towns, Chair of the House Oversight and Government Reform Committee 2009–2011, stated,

when it comes to interpreting the actual documents, too much complex information can lead to confusion. Too little information can be misleading.... From our experience, we know that understanding federal government financial statements and reports can be difficult, even for the experts. We need to have more readily available, simplified financial information in order to help both us here in the legislative branch, as well as the public. (Hatch, 2013)

More than 25 years since the passage of the CFO Act, academics, users, practitioners, and legislators agree there are significant problems within the federal financial reporting framework. The problems are perhaps best manifested in the fact that since mandated by GMRA, the government's consolidated financial statements have disclaimed an opinion, primarily because the auditors of the largest federal agency, the DOD, have disclaimed an opinion. The latest GAO audit report of the *Fiscal Year 2015 Financial Report of the United States Government* report dated February 25, 2016 states

[S]ince the federal government began preparing consolidated financial statements 19 years ago, three major impediments continued to prevent us from rendering an opinion on the federal government's accrual-based consolidated financial statements over this period: (1) serious financial management problems at DOD that have prevented its financial statements from being auditable, (2) the federal government's inability to adequately account for and reconcile intragovernmental activity and balances between federal entities, and (3) the federal government's ineffective process for preparing the consolidated financial statements. (GAO, 2016)

The view that corporate-style financial statements are not effective in the public sector extends beyond the United States to federal governments abroad as well. A 2006 survey of 25 Swiss accounting experts composed of politicians, administrative managers, and external consultants concluded the NPM model

cannot be efficiently integrated into public administration. As Flury and Schedler explain, “It is impossible to implement cost and performance accounting in public administration as an instrument purely for internal management. Politicians and managers [private sector] place different expectations on cost and performance accounting” (2006, p. 233).

Works by Barton (1999, 2005) and Stanton and Stanton (1997) expound on the difficulties of implementing business sector financial reporting practices in Australia, as does Biondi (2009) in France. Evidence from overseas appears to mirror the American federal government experience to date and corroborate that government policy and resource-allocation decisions are political in nature and may not depend on the financial information presented in CFO Act mandated statements (Brook, 2010, 2013). Hence, corporate-style financial reporting may not be appropriate for public administration.

IV. THE LOGIC OF CORPORATE-STYLE FINANCIAL STATEMENTS DOES NOT TRANSLATE WELL IN PUBLIC ADMINISTRATION

The previous chapter introduced evidence from users showing the current federal financial reporting format was not useful. This chapter explains why the logic of corporate-style financial statements does not universally apply to government administration. While well designed, private sector financial statements were intended for a wholly different purpose than government accounting. Preparation of the government's financial statements contradicts several of the foundational aspects of corporate GAAP including the matching principle, the definition of and how net position is determined, and the characteristics of an asset.

A. PURPOSE AND STRUCTURE INCONSISTENCIES

Corporate-style financial statements were developed and intended for use in for-profit private market environments. By contrast, governments are not for-profit (NFP) organizations. The measures of performance that are applicable to business enterprises cannot be directly applied to evaluate the success and accomplishment of government programs. Recognition that a common accounting approach is inappropriate is corroborated at the state and municipal level. A GASB white paper, titled *Why Government Accounting and Financial Reporting Is—and Should Be—Different*, offers an unambiguous assessment, stating,

Governments are fundamentally different from business enterprises. As a result, separate, accounting and financial reporting standards for governments are essential to meet the specific needs of users of government financial reports. The standards for governments need to reflect the unique environment of government, including different organizational purposes and special legal powers, and to effectively address the public accountability issues inherently related to the unique government environment. (GASB, 2013)

The matching principle is a basic accounting principles and directs an entity to report an expense on its income statement in the same period as the related revenues. This creates consistency in compiling financial statements. Financial statements may be misleading if expenses are not appropriately linked to revenues; compromising the quality of the statements and providing an inaccurate representation of the financial position of the entity. No revenue can be recognized until goods or services are provided.

However, in government, there is rarely a link between payment (taxes) and benefits dispensed. Public services, such as the national defense provided by the DOD, are consumed collectively and tax financing is necessary as non-payers cannot be excluded. The non-voluntary nature of government financing methods severs the link between service delivery—public goods and social benefits—and revenue recognition, making it impossible to match revenues and expenses (Sunder as quoted in Chan, 2003). Furthermore, appropriation law often prohibits the incurrence of costs until budget authority is provided; reversing the conditionality of the matching principle accounting logic. In summary, “taxes paid by an individual often bear little direct relationship to the services received by that taxpayer” (GASB, 2013, p. 1). The basic corporate accounting principle of matching expenses to revenues is impossible in government accounting.

The accounting balance sheet is one of the major financial statements required by the CFO Act. In corporate accounting, a balance sheet displays an entity’s financial position by reflecting a firm’s assets, liabilities, and shareholders’ equity at the end of a reporting period. The three components provide users information about what an entity owns and owes in addition to how much of the company was financed by shareholders. The balance sheet provides a summary of a company’s financial position at a particular point in time. The corporate balance sheet is prepared according to the following formula

$$\text{Assets} = \text{Liabilities} + \text{Shareholders' Equity}$$

The balance sheet is so named because the two sides of the equation must equal each other. The company's total assets listed on the left side of the equation must equal its total liabilities plus the equity of its shareholders' on the right side. This is logical. The assets purchased by a business enterprise must be financed either through borrowing money and taking on liabilities or raising capital by issuing stock (i.e., shareholder equity). Similarly, if the business entity liquidated its assets and paid off its liabilities, the residual would go to shareholders.

In federal government accounting, however, the balance sheet equation does not work in the same manner as the private sector. On the government's balance sheet shareholders' equity is replaced with a component called net position. Figure 2, FY 2015 DOD Consolidated Balance Sheet, clearly depicts this change. Consequently, in federal accounting, the equation is altered to read

$$\text{Assets} = \text{Liabilities} + \text{Net Position}$$

Simple arithmetic would dictate net position and shareholders' equity are therefore congruent, but this is not the case. As per SFFAC 2, net position is defined as "the residual between assets and liabilities" and "is generally composed of unexpended appropriations and the cumulative results of operations" (FASAB, 1995, para 84). Net position does not represent retained earnings or owners' equity as it does in the corporate world. The logic of the corporate balance sheet is therefore not paralleled in government financial reporting. Shown graphically, it is

$$\text{Assets} = (\text{Liabilities} + \text{Shareholders' Equity}) \neq (\text{Liabilities} + \text{Net Position})$$

The absence of private ownership and shareholders in the federal government (as previously explained, the public goods and social benefits provided by governments are financed through non-voluntary taxation) makes it problematic to apply the underlying principle of the basic accounting equation to the public sector (Chan, 2003, p. 15). Moreover, the information gleaned from calculating net position in federal accounting is arguably of limited value (see

Figure 1). Brook states, “The consequential meaning of net position is difficult to grasp. What, for instance, would year-to-year changes in net position tell us about the government enterprise?” (2010). In contrast, a similar change in the corporate balance sheet is readily interpretable.

Figure 1. FY2015 Department of Defense Consolidated Balance Sheet.
Source: DOD (2015).

Department of Defense Consolidated Balance Sheet Agency Wide		Dollars in Millions
As of September 30, 2015 and 2014	2015 Consolidated	Restated 2014 Consolidated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 487,374.4	\$ 480,352.3
Investments (Note 4)	844,664.9	783,736.3
Accounts Receivable (Note 5)	1,467.5	1,466.5
Other Assets (Note 6)	1,064.2	1,440.6
Total Intragovernmental Assets	\$ 1,314,571.0	\$ 1,266,995.7
Cash and Other Monetary Assets (Note 7)	1,142.2	1,286.5
Accounts Receivable, Net (Note 5)	6,190.9	6,519.9
Loans Receivable (Note 8)	1,526.4	1,452.2
Inventory and Related Property, Net (Note 9)	261,717.1	261,496.8
General Property, Plant and Equipment, Net (Note 10)	629,997.1	618,848.2
Investments (Note 4)	3,371.9	3,371.9
Other Assets (Note 6)	73,620.9	74,716.5
TOTAL ASSETS	\$ 2,292,137.5	\$ 2,234,687.7
Stewardship Property, Plant & Equipment (Note 10)		
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 1,432.7	\$ 1,911.2
Debt (Note 13)	1,508.6	1,392.3
Other Liabilities (Note 15)	7,699.5	8,746.8
Total Intragovernmental Liabilities	\$ 10,640.8	\$ 12,050.3
Accounts Payable (Note 12)	18,907.8	18,023.9
Military Retirement and Other Federal Employment Benefits (Note 17)	2,302,018.4	2,334,015.6
Environmental and Disposal Liabilities (Note 14)	60,030.1	58,581.4
Loan Guarantee Liability (Note 8)	66.5	56.8
Other Liabilities (Note 15)	34,927.1	35,945.4
TOTAL LIABILITIES	\$ 2,426,590.7	\$ 2,458,673.4
Commitments & Contingencies (Note 16)		
NET POSITION		
Unexpended Appropriations – Other Funds	\$ 474,792.9	\$ 501,692.9
Cumulative Results of Operations – Funds From Dedicated Collections (Note 23)	14,674.7	13,899.9
Cumulative Results of Operations – Other Funds	(623,920.8)	(739,578.5)
TOTAL NET POSITION	\$ (134,453.2)	\$ (223,985.7)
TOTAL LIABILITIES AND NET POSITION	\$ 2,292,137.5	\$ 2,234,687.7

B. THE SPECIFIC ISSUE OF ASSETS

As one of the three major components of the balance sheet is a listing of assets, it is imperative to understand the definition of an asset in accounting terms. In corporate financial reporting the FASB states in SFAC 6, titled *Elements of Financial Statements*, “Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events” (2008, para 22). Paragraph 26 further expands this definition:

An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others’ access to it, and (c) the transaction or other event giving rise to the entity’s right to or control of the benefit has already occurred. (FASB, 2008).

Therefore, a private entity may only recognize and list an asset on its balance sheet if it meets all three criteria. In federal financial reporting, the FASAB states in SFFAC 5, titled *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* the definition of a federal asset is “a resource that embodies economic benefits or services that the federal government controls” (2007, para 18). Paragraph 22 expands this definition with two criteria

To be an asset of the federal government, a resource must possess two characteristics. First, it embodies economic benefits or services that can be used in the future. Second, the government controls access to the economic benefits or services and, therefore, can obtain them and deny or regulate the access of other entities. (FASAB, 2007).

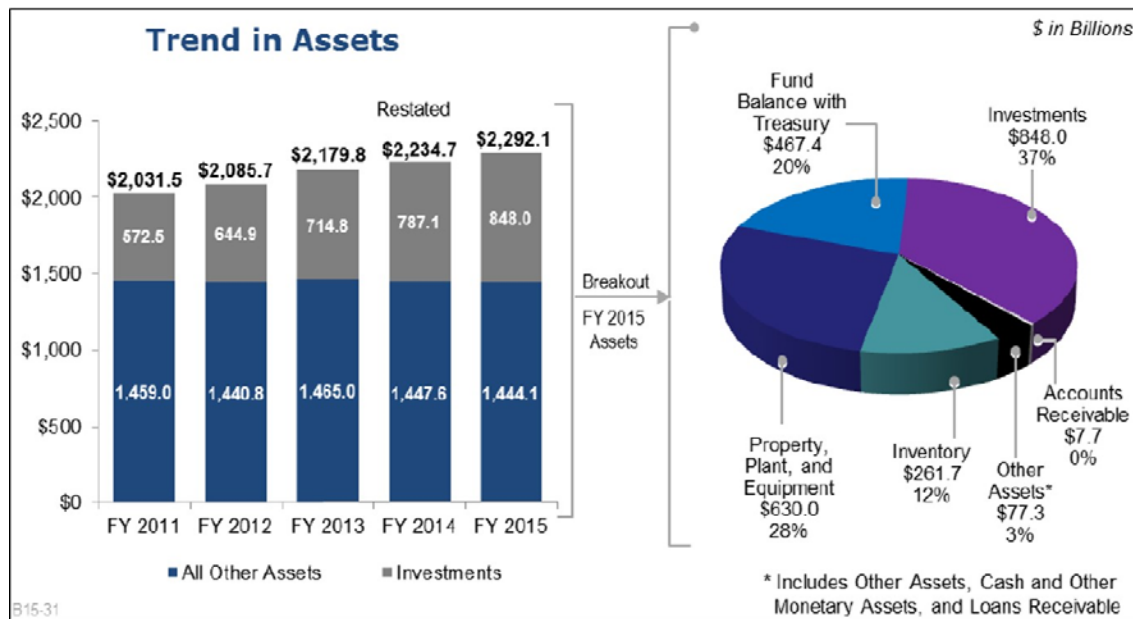
SFFAC 5 further clarifies that “economic benefits and services may result in inflows of cash, cash equivalents, goods, or services to the federal government, *whereas the services embodied in an asset may benefit the government in other ways [emphasis added]*” (FASAB, 2007, para 26). This distinction is crucial. Whereas corporate asset may only be recognized if it contributes to future cash flows owned by the firm, a government asset may be recognized regardless of whether it contributes to future cash flows or simply

provides services to the government or its citizens. “Economic benefits and services” constitutes a broad spectrum of intangible social benefits that do not create revenue.

The difference in the definitions defies the logic of the corporate balance sheet once again. Every corporate asset must possess the ability to generate future economic benefits; there is no room for interpretation. Indeed, a company that falsely reports assets on its financial statements is subject to potential prosecution. A significant percentage of federal assets do not contribute to future cash flows for the government and, therefore, should not be listed on the government’s balance sheet as per GAAP. They are acquired expressly to provide public goods and social benefits to citizens.

The DOD exemplifies this contention. As the largest federal agency, its FY 2015 financial statements listed more than \$2.2 trillion of assets of which the majority do not generate revenue for the government and were procured exclusively to provide national defense (DOD, 2015). Examples include the aircraft carrier U.S.S. *John F. Kennedy* and an M1A2 Abrams main battle tank. Figure 2 represents the classification of most of the assets that fall into the category as belonging to the property, plant and equipment portion of the overall DOD portfolio. The investment category is deceiving; this component of the DOD portfolio is utilized to fund future liabilities such as retirement pensions.

Figure 2. Department of Defense Asset Classifications.
Source: DOD (2015)



In addition to altering the corporate definition to suit federal accounting needs, FASAB recognizes several categories of assets. The government's portfolio includes property that serve a myriad of purposes and provide a variety of benefits—unlike business assets that solely provide future economic benefits—and this makes it problematic to include them under a universal definition for an asset. SFFAS No. 29, titled, *Heritage Assets and Stewardship Land*, defines heritage assets as

[P]roperty, plant and equipment (PP&E) that are unique for one or more of the following reasons:

- historical or natural significance,
- cultural, educational, or artistic (e.g., aesthetic) importance; or
- significant architectural characteristics.

Heritage assets consist of (1) collection type heritage assets, such as objects gathered and maintained for exhibition, for example, museum collections, art collections, and library collections; and (2)

non-collection-type heritage assets, such as parks, memorials, monuments, and buildings. (FASAB, 2005)

Heritage assets are managed by the government to provide cultural benefits and they do not generate revenue or facilitate government administration. Additionally, the operation of heritage assets is largely financed by taxation. Additionally, as stated by Barton, the benefits “are provided to the public on a non-discriminatory and non-exclusive basis and all citizens have democratic rights to use them” (Barton, 1999, p. 222). He states further that the benefits provided by heritage assets accrue with the citizens, rather than to the government (Barton, 1999). It is not possible (as is the case with national defense) to quantify monetarily the benefits provided by heritage assets. The investment to operate and maintain a heritage asset and the subsequent return on this investment in the form of social and cultural benefits are not the same units of measure. Therefore, heritage assets differ fundamentally from business assets and are not a relevant component of the government’s financial position. On this basis, it is inappropriate to attempt to match them to an associated liability on the balance sheet.

Stanton (1997), Barton (1999, 2005) and Biondi (2009, 2014) assert the government should not list heritage assets on its balance sheet. Instead, they believe heritage assets should be managed by the government in the form of a trust arrangement for the benefit of the citizens. Barton’s slant is grounded in the assertion that the Washington Monument, for example, is not an asset for the United States government. As it generates only liabilities (from a financial perspective), it should not be included in general purpose financial statements and should be accounted for in a different manner due to its unique nature (Mautz, 1988 as quoted in Barton, 1999).

How then to account for them? Barton posits, “[They] should be regarded as assets of the nation which are managed by government as a trustee for benefit of the society; and that, as trust assets, they should be accounted for separately from administrative assets of government” (Barton, 1999, p. 220).

Furthermore, because heritage assets do not exist to generate revenue for the government, the information related to their management is not the same as the financial information required of private sector business entities.

The distinction between assets that generate economic benefits (e.g., revenue), and those that do not is a central theme of this thesis. If an asset is not intended to produce economic benefits should it be accounted for with a financial reporting framework designed to measure this very component? If corporate-style financial statements are not the most effective method to account for this type of government asset, what approach or model would be better?

C. ECONOMIC BENEFITS VERSUS SOCIAL, CULTURAL, SECURITY, AND DEFENSE BENEFITS

Barton (2005) recommends significant modification of government accounting and advocates two distinct categories of government assets—commercial type assets and social and environmental assets—differentiated by whether the benefits and services provided by the asset accrue to the government or the people. Commercial type assets “... are resources over which the entity has management responsibility to use in provision of future economic benefits to the government or the public as beneficiaries...” (2005, p. 149). These assets conform to the FASB GAAP definition of an assets and it is appropriate to include them on the government’s balance sheet. Social and environmental assets on the other hand

are resources, both economic and non-economic, over which the entity has management responsibility to provide social benefits to the public and which are normally conserved and maintained by government for the benefit of current and future generations (2005, p. 150).

As social and cultural resources do not generate future economic benefits, they should not be included on the balance sheet. This is a logical assertion and is corresponds to corporate GAAP.

The argument to not include heritage assets on the government balance sheet raises the question of whether it is appropriate to view other government assets through a similar lens. The vast majority of the assets managed by DOD are not utilized for the purpose of generating revenue for the government. Military equipment (e.g., weapon systems, personnel, base infrastructure) are operated to provide social benefits to the country, namely national defense. As they do not generate future cash flows, it is illogical to apply corporate GAAP to account for them; therefore, it is misleading and inappropriate to include these assets on the government's balance sheet.

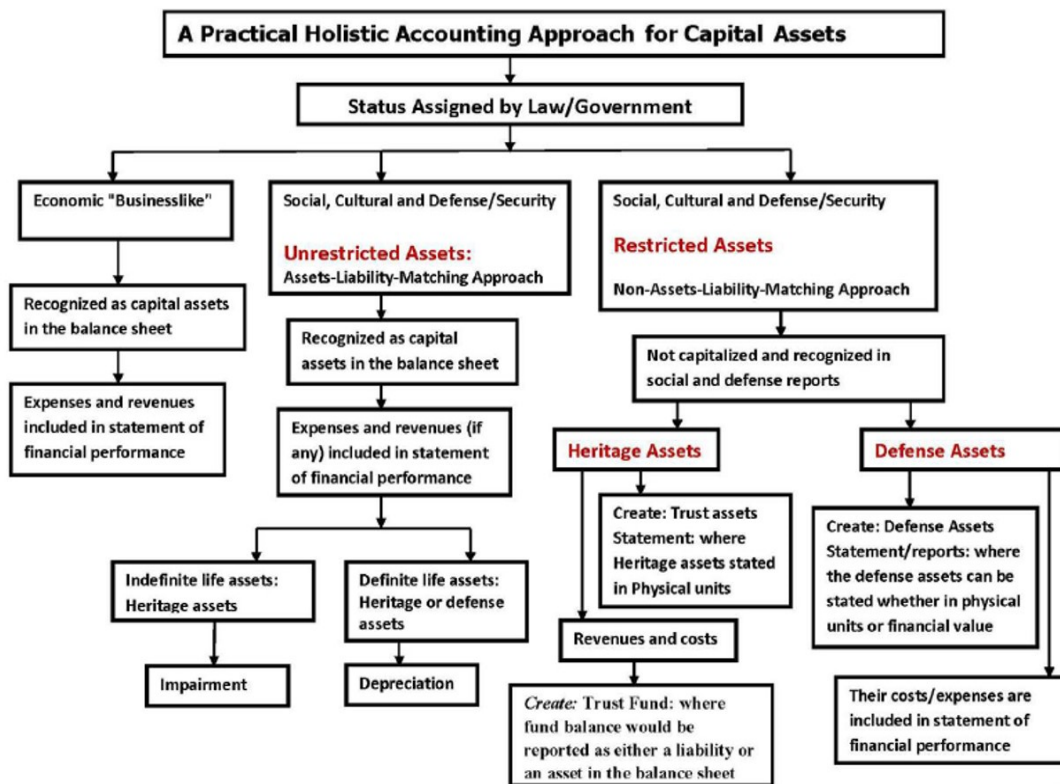
Ouda (2015, 2016) advocates a “holistic practical approach” to public sector accounting, which (just as Barton does) differentiates government assets into two primary categories based on the type of benefit they provide, either (1) economic (monetary) benefits (i.e., non-tax based revenue), or (2) benefits that provide social, cultural, defense, and security services. Refer to Figure 3 for a depiction of Ouda's accounting framework.

Those assets that provide economic benefits and conform to the FASB GAAP definition of an asset are recognized as capital assets and included on the balance sheet. Examples of these “businesslike” assets include government bonds, leases on government property of infrastructure, and the sale of resources from government property. This category constitutes a significant percentage of the government's portfolio and should be accounted for in a manner that accurately reflects its unique purpose.

The second category of government assets that provide non-monetary social, cultural, defense, and/or security benefits—for example heritage assets and military PP&E—are further separated into two distinct types: unrestricted or restricted. Unrestricted assets are so designated if the matching principle can be logically applied to them, and there are no legal, social, cultural, defense, security restrictions against their sale or disposal. Just as economic assets are, unrestricted assets are recognized as capital assets and included on the balance sheet. Examples of unrestricted social, cultural, defense and/or security assets

include government property and infrastructure that generate no revenue, but can be disposed of, for example, through the base realignment and closure (BRAC) process. Restricted assets are those to which the matching principle cannot be logically applied and there are legal, social, cultural, defense, and security restrictions precluding their sale or disposal. The DOD's fleet of F-35 Joint Strike Fighters is an example of a restricted defense asset while the Lincoln Memorial is indicative of a restricted cultural asset.

Figure 3. The Practical Holistic Accounting Approach.
Source: Ouda (2016).



D. FEDERAL MISSION AND NATIONAL DEFENSE PP&E

Recognition of defense assets as a unique category of government asset is not without precedent in the United States. The FASAB identified the unique purpose of military equipment in 1996 and originally prescribed a separate category of assets titled federal mission PP&E when it promulgated SFFAS No.

6. In addition to federal mission PP&E, FASAB recognized heritage assets and stewardship land as government assets wherein “the depreciation effect of the asset on operating performance was not the predominant reporting objective. Instead, stewardship was important” (FASAB, 2003). The three categories are referred to collectively as stewardship PP&E, and in 1996, FASAB issued SFFAS No. 8, *Supplementary Stewardship Reporting*. According to FASAB,

“Stewardship PP&E” consists of items whose physical properties resemble those of general PP&E traditionally capitalized in financial statements. However, the nature of these Federal physical assets that are classified as stewardship PP&E differs from general PP&E in that their values may be indeterminable or may have little meaning (e.g., museum collections, monuments, assets acquired in the formation of the nation) or that allocating the cost of such assets (e.g., ND [national defense] PP&E) to accounting periods that benefit from the ownership of such assets is not meaningful. Specifically, for ND PP&E the majority of the Board did not believe applying depreciation accounting for these assets would contribute to measuring the cost of outputs produced, or to assessing operating performance, in any given accounting period. The Board believed that these assets were developed, used, and retired in a manner that did not lend itself to a “systematic and rational” assignment. (2014)

Therefore, as early as 1996, the FASAB recognized a single definition of an asset in a common accounting system were not appropriate for government administration. This passage is telling in that the board specifically describes the illogic of applying corporate GAAP to accounting for government property, specifically military equipment—one of the main points of this thesis—and initially attempted to recognize the unique characteristics of these assets.

To prevent “confusion, inconsistency, and unintended application,” FASAB subsequently discontinued use of the term federal mission PP&E in 1998 and replaced it with national defense PP&E (ND PP&E) as per SFFAS No. 11, *Amendments to Accounting for Property, Plant, and Equipment—Definitional Changes—Amending SFFAS 6 and SFFAS 8 Accounting for Property, Plant, and Equipment and Supplementary Stewardship Reporting*. The guidance more specifically defined ND PP&E as

PP&E [that] are (1) the PP&E components of weapons systems and support PP&E owned by the Department of Defense or its component entities for use in the performance of military missions and (2) vessels held in a preservation status by the Maritime Administration's National Defense Reserve Fleet. (FASAB, 1998)

In 2003, FASAB rescinded the category of ND PP&E in SFFAS No. 23, Eliminating the Category National Defense Property, Plant and Equipment and reclassified it as general PP&E. In essence, FASAB reclassified all DOD property under the umbrella of a single convenient definition. It is perplexing how at one time FASAB recognized DOD assets as a distinct category of government property wherein stewardship and management were considered of greater importance than financial data, only to abandon this approach a short time later.

Eliminating the ND PP&E category only served to make accounting uniform across agencies, when, perhaps, a different system that recognizes these differences would be more useful. Furthermore, the decision raises questions of whether consistency on the one hand, or relevancy and accuracy on the other, were FASAB's primary objective. It should be noted at the time, both the board and the federal accounting community were divided on this decision. A dissenting board member based his vote in part on the belief "[that] (2) additional disclosures are important to meeting reporting objectives for National Defense PP&E" (FASAB, 2003).

The previous chapters demonstrate that government's social and public focused organizational purpose is divergent from the logic of corporate-style financial reporting. Furthermore, government property does not appear to fit neatly into the single corporate GAAP definition of an asset. Given the financial statements are not useful to federal users, is there a better approach to government accounting? Would Barton's trust administration model for heritage assets work within Ouda's holistic practical approach framework and its distinction between "businesslike" economic assets and those that provide social, cultural, security, and defense benefits?

V. THE TRUST MODEL

This chapter introduces the concept of a trust. This chapter explains the purpose, major components, and operation of trust administration. Next, it discusses the fiduciary duties of trustees in detail. The chapter continues with an outline of the key differences between private and charitable trusts. Finally, the chapter concludes with a description of charitable trust accounting practices and the characteristics of not-for-profit financial reporting.

A. ELEMENTS OF A TRUST

A trust is a legal arrangement where a person transfers legal ownership of their property to a second person (or group of people) to be managed for the benefit a third person (or group of people). The property put into trust can be any type of asset, both tangible and intangible. The overarching purpose of a trust arrangement is to link property to a specific purpose. Refer to Figure 4 for a depiction of the trust arrangement.

The person who gives the property and establishes the trust is usually known as the “settlor.” The person who is requested to manage the property in accordance with the settlor’s intentions is called the “trustee.” The person who benefits from the management of the trust property is called the “beneficiary.” The terms of the trust arrangement are listed in a “trust deed” or “trust instrument,” and the property placed in the trust is called the “trust fund” or “trust principal.”

The settlor may also elect to give the authority to select the new owner of the trust property to a person (or group of people) called the “appointee.” This authority is referred to as the “power of appointment” and confers to the appointee the authority to nominate a third party to manage the trust property on behalf of the beneficiaries. Therefore, the appointee is granted the power to nominate trustees.

Unlike a business enterprise, a trust cannot legally own assets. Trust property rights are bifurcated between the trustee and beneficiary, and consequently, “[t]he distinctive feature of a trust is the separation of legal ownership and beneficial ownership of the assets in the trust fund” (STEP, 2016). The trustees become the legal owners of the trust property and owe a fiduciary responsibility to the settlor. Among other obligations, the trustee must, in all cases, place the interest of the beneficiaries above her or his own.

An example of a very basic private trust is as follows:

Michael establishes a trust and transfers \$1 million and his home to Rebecca. Michael instructs Rebecca to invest the money and rent out the home with all investment income and rent proceeds to be paid to Benjamin for life. On the occasion of Michael’s death, Rebecca is to sell the house and give the proceeds to William.

Michael is the settlor.

The trust property is the \$1 million and home.

Rebecca is the trustee and owes a fiduciary responsibility to the beneficiaries.

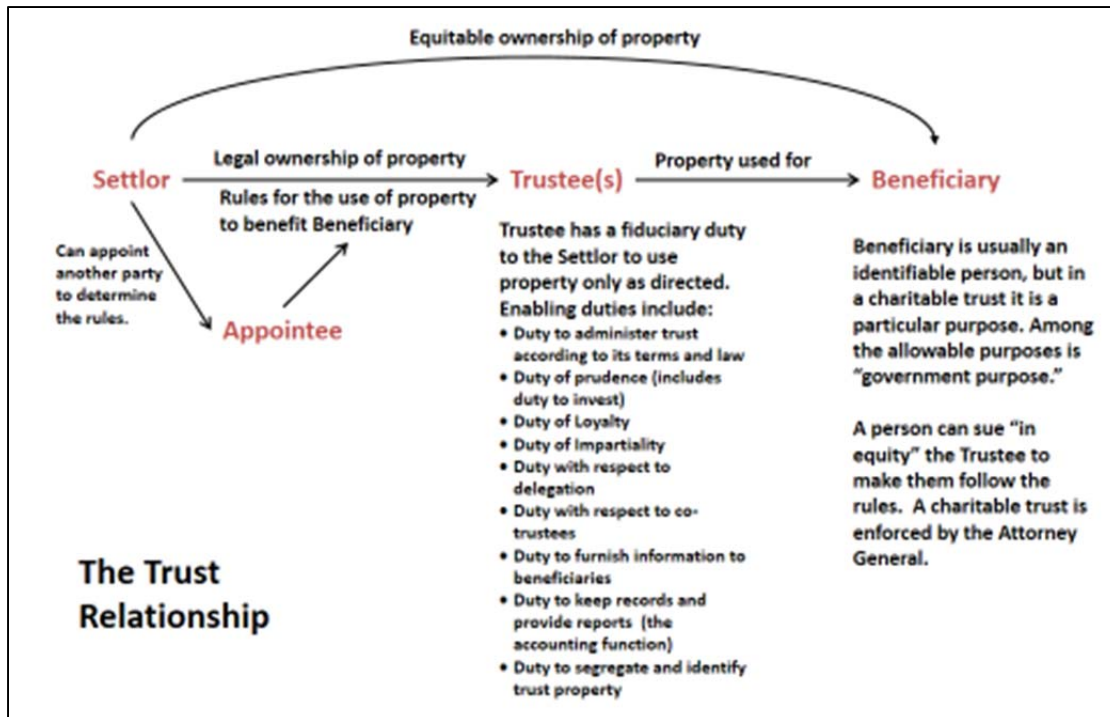
Benjamin and William are the beneficiaries.

In order to create a valid trust, a series of criteria must be met. (1) The settlor must have both the capacity (cognitive) and intent to create a trust. (2) There must be at least one clearly identified beneficiary and a valid purpose. The beneficiary may include a specific purpose as in the case of a charitable trust. (3) The trust property must be clearly identified and ascertainable. (4) There must be duties for the trustee to perform—this criteria is explained in detail later in the chapter.

The trust document, referred to as a “trust instrument,” governs both the administration of the trust and the distribution of property. Based on terms establishing the trust, it may last for a long period of time. It is possible that many factors may change including the needs of the beneficiaries, the law and

unforeseen circumstances that impact the settlor's intent. At their discretion, both the settlor and his or her appointee may modify the trust.

Figure 4. The Trust Relationship. Source: Candreva (personal communication, November 10, 2016).



B. CHARITABLE TRUSTS

A charitable trust is one that serves a specific charitable purpose. Per common law, charitable purposes include: poverty relief, the promotion of education or religion, health, governmental or municipal purposes; or the general benefit of the community. In a private trust, the beneficiaries must be ascertainable, but in a charitable trust the benefits provided from management of the trust property are conveyed to an undefined body of persons meeting a particular description. The beneficiaries of a charitable trust are unascertainable and cannot be identified at the time the trust is created. Therefore, charitable trust beneficiaries can be any person who fulfills the trust's objectives or the purpose for which the trust was established.

Enforcement of charitable trusts differs from private trusts. In the case of a charitable trust, it is the duty of the attorney general of each state to supervise administration of the trusts. However, private trusts are enforced by the beneficiaries in state and local municipal courts. The identity of the beneficiary in a private trust is important because it defines to whom the trustee owes fiduciary duties and establishes the beneficiary's legal standing with a court of law to enforce the trust. Typically, charitable trusts have more than one trustee and allow for the trustees to act if the majority assents to an action. In most instances, private trusts with multiple trustees require unanimous consent of all trustees unless the trust document stipulates otherwise.

An example of a charitable trust is the J. Paul Getty Trust, which describes itself as "a cultural and philanthropic institution dedicated to critical thinking in the presentation, conservation, and interpretation of the world's artistic legacy" (J. Paul Getty Trust, n.d.). The trust was established in 1953 by J. Paul Getty. Following his death in 1978, the majority of his personal estate passed into trust in 1982. In the years since, the trustees have managed the entity as per the mission outlined in the trust indenture, the document by which Getty created the trust. In it, he named "the diffusion of artistic and general knowledge" as the trust purpose and in doing so designated the beneficiaries as any person or persons who satisfied this requirement. Currently, J. Paul Getty's mission is carried out through four programs: the J. Paul Getty Museum, the Getty Research Institute, the Getty Conservation Institute, and the Getty Foundation.

C. DUTIES OF THE TRUSTEE

The objective and duty of every trust and trustee is to serve the beneficiaries according to the terms of the trust. As it is not possible to stipulate every requirement in the trust agreement and because the trustee's compensation is not linked to the performance of the trust, it is necessary to impose a fiduciary obligation on the trustee. The beneficiaries are left to enforce the terms of the trust as well as the trustee's fiduciary obligation. By accepting

legal title for the trust property, the trustee owes the beneficiaries a number of duties. The duties include

- the duty to administer the trust according to its terms: [The Trustee] is obligated to carry out the settlor's intentions, as stipulated in the trust agreement. [T]he trustee can delegate some of the duties to others; however, the trustee is still personally responsible for the administration of the trust assets and must therefore use care when delegating duties to others. (National Paralegal, 2010)
- the duty of loyalty: The trustee is under a duty of absolute loyalty to the beneficiaries. The trustee must put the beneficiaries' interests before his/her own and administer the trust solely for their benefit. As such, the trustee must not undertake any transaction that would be adverse to the beneficiaries' interests, especially avoiding any self-dealing. (National Paralegal, 2010)
- the duty of prudence: The trustee must administer a trust with a degree of care, skill and caution. In some cases, this includes prudently investing the trust assets to earn a return.(NEED TO FIND A CITATION)
- the duty of impartiality: A trustee must administer a trust so as to afford each beneficiary with the same level of benefits and protection. The duty extends to current as well as successive beneficiaries. (Anderson Firm, 2014)
- the duty with respect to delegation: A trustee owes to the settlor and beneficiary the responsibility to personally carry out the management of trust assets and other matters that the Trustee has agreed to undertake. However, a trustee may delegate to a subject matter expert should the trustee require expert advice. (Anderson Firm, 2014)
- the duty with respect to co-trustees: A trustee holds dual accountability for their own actions, inactions and decisions, as well as those of his / her co-trustee(s). While many co-trustees "split" duties, it is important for all Trustees to continually monitor their co-trustee's actions and verify that the co-fiduciary is acting properly. (Anderson Firm, 2014)
- the duty to inform and account: The law of trusts has always imposed a duty on the trustee to keep the beneficiary informed as to the administration of the trust and to account to the beneficiary for all actions taken by the trustee. Without

a proper accounting disclosing how the trustee has handled the trust affairs, there is little chance of a trustee being held accountable and therefore, the trustee's duties could be breached at will without any means of redress. The burden of proof is on the fiduciary to show that he has fully performed his duties, and the means for such proof is by providing a sufficient and proper accounting. (Fleece, n.d.)

- the duty to keep records and reports: A trustee has a duty to maintain clear, complete, and accurate books and records regarding the trust. It is important for the trustee to keep clear and complete records so that the beneficiary can tell whether the trustee has acted with prudence, loyalty, and impartiality and whether the costs of administration have been reasonable and appropriate. (Fleece, n.d.)
- the duty to segregate and identify trust property: The trustee is required to keep trust assets separate from his/her own assets and earmark them as specifically associated with the trust. (Fleece, n.d.)

Stewardship and accountability are the central themes inherent to the duties of a trustee. The beneficiaries may hold the trustee to a very high standard of performance and conduct to enforce the terms of the trust. Consequently, the trustee must thoroughly understand and abide by the terms of the trust as well as the applicable law. Trustees must communicate regularly with the beneficiaries and keep them informed on the status of the trust property. Finally, as legal owner of the trust assets, trustees are statutorily recognized as the decision maker for all matter of the trust.

D. TRUST FINANCIAL ACCOUNTING AND REPORTING

A trustee is a person who has broad discretion with very little oversight over someone else's property. Practically the only time a beneficiary can review what the trustee has done and have an opportunity to challenge those actions is when the trustee provides an accounting to the beneficiary. As such, one of the many duties a trustee has is the duty to inform and account. This fiduciary duty is critically important to ensure that the trustee is properly discharging his or her fiduciary duties in managing the affairs of the trust. (Fleece, n.d.)

In a private trust arrangement, the requirements pertaining to the trustee's duty to report vary state by state. In general, however, this duty is fulfilled by delivering a trustee's report to the beneficiaries on an annual basis at a minimum. The annual trustee's report bears some similarities to corporate-style reporting in that it must include an up-to-date list of trust assets and liabilities and as well as bookkeeping for all revenues and expenditures during the reporting period. The similarity stops here though. There is no statutory form or GAAP for this report. Trustees may choose any format for the annual report as long as it contains enough information to satisfy the needs of the beneficiaries.

Charitable trusts fall under the umbrella of NFP organizations and are subordinated to FASB's guidance. Stewardship, management performance and measure of mission accomplishment are the principle concerns of NFP reporting in contrast to private sector reporting and its heavy focus on earnings and components. Financial reporting for private not-for-profit (NFP) organizations is outlined by FASB in SFAC 117, *Financial Statements of Nonprofit Organizations*. Governmental nonprofit financial reporting guidelines are established by GASB in Statement No. 29, *The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities*. GASB directs governmental NFP entities to apply SFAC 117 guidance. As per SFAC 117:

The primary purpose of financial statements is to provide relevant information to meet the common interests of donors, members, creditors, and others who provide resources to not-for-profit organizations. Those external users of financial statements have common interests in assessing (a) the services an organization provides and its ability to continue to provide those services and (b) how managers discharge their stewardship responsibilities and other aspects of their performance. (FASB, 1993)

NFPs are required to prepare and submit auditable annual financial statements that differ significantly from federal and corporate-style statements. The purpose of one of the statements, the statement of activity (also called an income and expense statement), is noteworthy:

17. The primary purpose of a statement of activities is to provide relevant information about (a) the effects of transactions and other events and circumstances that change the amount and nature of net assets, (b) the relationships of those transactions and other events and circumstances to each other, and (c) how the organization's resources are used in providing various programs or services. The information provided in a statement of activities, used with related disclosures and information in the other financial statements, helps donors, creditors, and others to (1) evaluate the organization's performance during a period, (2) assess an organization's service efforts and its ability to continue to provide services, and (3) assess how an organization's managers have discharged their stewardship responsibilities and other aspects of their performance. (FASB, 1993)

The tact of this statement represents a fundamental departure from the for-profit accounting. The degree to which NFP entities accomplishes their mission is clearly recognized by FASB as not directly related to earnings and components. Non-financial information is of greater importance and relevance in determining trust and nonprofit performance over a period of time. Consequently, NFP financial statements are purposefully designed to be flexible, useful, and informative in order to link property to purpose. One of the principle aspects of trust accounting is the statement users do not need to be a financial or accounting experts to understand it. NFP accounting is designed to be useful primarily to beneficiaries and donors and, when required, judicial officials to determine if the trust property is being administered in a manner commensurate with the settlor's intent, i.e., terms of the trust. An extensive accounting background is not a requisite necessity to make sense of NFP financial statements and reports and contrasts with the experiences of users of federal reports (AGA, 2008; Steinhoff & Dacey, 2008; CFOOC, & CIGIE, 2011).

The rationale behind the reporting guidelines is based in recognition that NFP organizations are fundamentally different from business enterprises. They exist to serve a specific purpose and not to generate profit. Nonprofits and trusts are judged based on how effectively they provide benefits to the target audience. It is logical that these differences should be considered when formulating NFP

financial reporting standards. An additional consideration is the degree to which the missions and purposes of NFP organizations vary. A universal accounting system simply cannot meet needs of every user. Hence, trust and nonprofit financial reporting varies to a far greater degree than reporting in the private sector.

Of particular note are informational disclosures about certain types of donations. Donations are classified as unrestricted and restricted. Unrestricted donations may be used by the entity in any manner it deems fit. Restricted assets must be used expressly for the purpose designated by the donor. Generally, donors will require much greater detail about the use of restricted funds. This requirement serves to inform the donor that the conditions of the gift have been (or are being) met, and enables the NFP management to track what funds remain available for the restricted purpose.

The overarching theme of trust and NFP accounting is to provide useful information, in many instances non-financial data, to stakeholders. The flexibility afforded trustees in preparing financial statements enables them to tailor the reports to include information that is useful and relevant. NFP accounting is unconstrained and trustees may choose any format to present the reports so long as the information is detailed enough to meet the needs of the beneficiaries.

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VI. APPLYING THE CHARITABLE TRUST MODEL

The process of the government collecting taxes and using this revenue to provide public goods and social benefits to its citizens looks very similar to the trust arrangement. This chapter overlays the operation of a charitable trust onto the federal government's administration and accounting of the DOD and its associated property. The chapter explains how each of the financial statement users groups identified by FASAB—citizens, the Congress, executives, program managers—are equitably and appropriately represented within the trust administration and the process by which the trust property is put into trust. The chapter concludes with a point by point comparison of the similarities between the fiduciary duties of a trustee and the tenets of public administration that apply to defense officials.

A. THE NATIONAL DEFENSE TRUST

The citizens of the United States are settlors who give the power of appointment to Congress through the democratic process. The American political system is a representative democracy by which citizens elect legislators to make policy decisions and enact laws on their behalf. Those wishing to run for office must listen to the will of the people and execute political campaigns based on public policies they believe will best serve the needs of the nation. National defense is one such policy.

By exercising the right to vote and determining which governing officials will represent their interests, the citizen settlors have executed the power of appointment. The act of voting legislators into public office is comparable to a settlor who appoints a third party, the appointee, to decide the manner in which trust property will be managed to achieve the trust's mission. The settlor confers the authority to administer the trust property in the same manner as citizens choose their elected officials to manage the country's affairs.

Once elected, Congress then establishes a charitable trust and names the purpose of national defense through annual appropriation and authorization legislation. This legislation, in conjunction with other pertinent statutes and the Constitution, form the trust instrument. The bills are written to allocate monies and provide budgetary authority to fund DOD programs, which accomplish the trust's mission. National defense falls within the realm of governmental purposes and is recognized under common law as a valid charitable trust purpose. The beneficiaries of national defense comprise every citizen and are therefore unascertainable. As the beneficiary and purpose are identical, the trust is charitable by nature.

National defense trust property originates as taxpayer revenue and is placed into trust through the appropriation and authorization process. The military is restrained with how it may invest trust property by appropriation laws related to purpose, time, and amount (i.e., the necessary expense rule, the bona fide need rule, and Antideficiency Act respectively). The trust property is invested in installations and infrastructure as well as defense programs such as weapon systems, research and development, operating expenses, and personnel in order to achieve the trust's purpose of national defense. The appropriations are to be prudently invested to create specific military capabilities that are in turn managed by the DOD.

As the appointee, Congress then appoints trustees in the form of defense executives and officials to accomplish the trust's mission. The trustees are national defense subject matter experts and include, among others, the Secretary of Defense, the Chair of the Joint Chiefs of Staff, the service chiefs, defense agency heads, and combatant commanders. The trustees are given legal custody of the national defense property and use it to achieve the trust's objective of national defense. For example, combatant commanders are equipped with trust property to achieve regionally specific objectives related to the trust's overarching national defense mission.

Paralleling charitable trust law, property rights remain bifurcated between the citizen settlors and defense official trustees as required by trust administration. The nation's citizen taxpayers, as the settlors, no longer legally own the trust property (tax revenue) they contribute to the government. They have transferred legal custody of the property to appointees (the democratically elected Congress) who nominate trustees (DOD executives and officials) to manage the trust property for the purpose of the trust (national defense). The citizen settlors are now the beneficial owners of the property and the benefits the trust property provide flow exclusively to them in a non-rival and non-exclusive manner.

There is broad overlap between the fiduciary duties imposed on the trustees and the tenets of public administration, namely stewardship and accountability. The military personnel and federal employees who comprise the body of national defense trustees, swear an oath of allegiance to the Constitution. This act is analogous to a trustee's duty of loyalty and the incurred obligation to administer the national defense trust solely in the interest of the beneficiary.

Defense trustees are limited by fiscal law on how they may spend the trust property. Additionally, the military is constitutionally subordinate to the civilian leaders who dictate the armed forces' missions. Defense official trustees must manage trust property in order to execute the mission of the trust within specific guidance from elected official while remaining within the bounds of the law. This obligation mirrors the duty to administer a trust according to its terms and the trustee's fiduciary responsibility to execute the trust as per the terms of the trust.

Defense officials are entrusted with missions that can easily destabilize geopolitical events and operate weaponry capable of great destruction. They are entrusted to be good stewards of the national defense trust property which correlates directly to the trustee's duty of prudence and obligation to administer the trust with a degree of care, skill and caution. Defense officials are often called to provide expert testimony to Congress regarding national defense subjects.

They must routinely account for the substantial property entrusted to their management as well as its accomplishments and the results of its operations. In doing so, they fulfill the trustee's duty to keep and maintain accurate records and reports as well as the duty to inform and account.

The manner in which the federal and military chain of command operates holds leaders accountable for the actions of their organizations and mission accomplishment. The duty with respect to co-trustees is very similar in this regard, requiring trustees to be aware of the actions of fellow co-trustees and being accountable for the performance of the trust. The defense officials must remain unbiased in the performance of their duties. In executing their missions, defense officials can legally delegate authority, but cannot delegate overall responsibility for the outcome. They are personally responsible emulating the trustee's duty with respect to delegation. Inventorying and accounting for taxpayer equipment is an essential aspect of military service and dovetails into the trustee's duty to segregate and identify trust property.

B. BENEFITS OF THE CHARITABLE TRUST APPROACH

The charitable trust model more appropriately conforms to the nature of the DOD's "business." Hanks (2009) describes the relationship between federal government and DOD as a "forward looking compact." On behalf of the citizens of the country, Congress expects DOD to utilize the public resources entrusted to it—tax revenue—to provide national defense against future threats. Unlike corporate-style financial statements, which are retrospective, based on historical data, and at best provide a current snapshot of an entity's financial well-being, trust administration and financial reporting is designed to be useful to stakeholders to make decisions looking forward.

The charitable trust model addresses the importance of nonfinancial data. The distinctive purpose or mission of a charitable trust is divergent from the universal profit motive that drives the private sector. For users of corporate-style financial statements, the specific product or service produced by the entity is an

irrelevant factor to interpreting the financial data. The purpose and structure of for-profit reporting is designed around the common objective of determining profitability. Nonfinancial data is not a major concern for business sector users. By contrast, nonfinancial information is a critical component to determining the performance of nonprofit organizations (e.g., the federal government) and the outcomes of their programs. Charitable trust reporting is purposefully designed to address users' desire for qualitative nonfinancial information.

The greatest benefit of the charitable trust arrangement, as it directly relates to the DOD, is the ease of accounting. Nonprofit reporting is not constrained by rigid GAAP and it is these requirements that continue to frustrate the DOD's efforts to achieve CFO Act compliance. The absence of a statutorily mandated format affords the defense trustees a great degree of flexibility in preparing reports to the beneficiary. This flexibility presents significant opportunities to improve the current reporting model regarding timeliness. A less technical format can be prepared and submitted for audit sooner, ensuring CFO Act compliance in a meaningful way.

The trust arrangement eliminates the illogic of applying corporate-style financial reporting to government administration. The two sectors fundamentally differ and require separate and distinct accounting systems. The trust model represents a sharp departure from current thinking and moves away from the historically unsuccessful attempts to modify the corporate system to meet government needs. "In the private sector, the purpose is financial (profit) and the means are activities. In the public sector, the opposite applies: The purpose is activities and the means are financial" (Strom 1997, as quoted in Barton, 1999). The trust arrangement and its associated financial reporting is purposely specific in applying this principle to property management.

There is broad overlap between the fiduciary duties required of trustees and the views of public sector administration, namely stewardship and accountability. The two systems are essentially ethically synonymous and implementation of the trust model requires zero revision of the current

expectations regarding the professional conduct of government employees. The trust foundation overlays very cleanly in this regard.

The trust arrangement and its reporting is elegant in its simplicity. The trust links property to a specific purpose in order to serve a beneficiary. The parallel with military assets managed by the DOD and its administration to provide national security on behalf of the nation is obvious. The vast majority of citizens are not technical experts in defense issues. Charitable trust reports are specifically designed to enable beneficiaries to understand the information without possessing technical expertise.

While qualitative nonfinancial data may be regarded as inexact and objective in nature within the accounting community, the measurement of national defense is clearly an inexact proposition and not possible with financial accounting models. Charitable trust reporting offers a significant advantage over the current federal financial reporting statutes in this regard. Reports can be tailored to provide useful information to stakeholders. They can evolve and change as necessary to meet new requirements (just as adversaries continually develop new capabilities that must be countered). Charitable trust reporting is uniquely designed to provide the defense trustees an appropriate means to supply beneficiaries with information. It links financial resources to a desired nonfinancial outcome. Continuing to attempt to quantify the accomplishments and results of DOD operations with financial data will only extend DOD's audit compliance and reporting troubles.

In summary, corporate-style financial statements do not provide DOD stakeholders with the information they need to make decisions about the administration of the agency. Concerns regarding the usefulness and utility of the statements span the spectrum of users—citizens, Congress, executives, and program managers—and, coupled with the logical weaknesses presented in this thesis, provide a significant base of evidence to support this assertion. FASAB's desire to make information to users reliable, relevant, consistent, understandable, comparable, and timely will not occur until the current model is

reengineered. Efforts to force the unique nature of government administration into a system designed to measure a very narrow and explicitly defined purpose will continue to fall short. Even if the DOD were to achieve CFO Act compliance and produce auditable financial statements, what good can result from spending billions of dollars to produce reports that few understand and even fewer use?

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VII. RECOMMENDATIONS AND LIMITATIONS

This thesis recommends federal stakeholders consider the merits of charitable trust administration and reporting practices for DOD. After 20 plus years of unsuccessful CFO Act compliance activities, it is time to readdress the problem set and seek an alternative solution. This thesis is meant to serve as a start point for a new discussion and to promote a healthy dialogue among stakeholders to achieve this goal.

This thesis stops short of recommending a specific format for government financial statements and is limited in this regard. Implementation of the charitable trust model is restricted to a purely conceptual basis. Future research should begin with the following areas of concentration: (1) developing new accounting methods to classify DOD assets in a more useful way and (2) developing reporting formats that recognize the new assets classes and are service component or agency specific.

Future research should attempt to develop an alternative accounting system that categorizes government assets in a manner similar to Ouda's framework. He makes a very convincing case for at least four types of assets. Of these, only one type completely conforms to the corporate GAAP definition of an asset. The treatment of DOD property is a central point of contention and before a new reporting format can be considered, the issue of assets must be adequately addressed. It is fruitless to continue attempting to fit the government's many different types of property into a private sector accounting system and expect a new outcome.

This thesis recommends researchers attempt to design a reporting format that is specific to the service components and various organizations that make up the DOD claimancy. The DOD is comprised of 33 reporting entities for financial statement audit purposes. Many of them conduct corporate-like operations (e.g., Defense Logistics Agency or the Defense Commissary Agency) and this thesis

concur that the current form of accounting is appropriate for these entities. But for the military service general funds, the evidence presented suggests the charitable trust model appears to be more useful and meaningful. Coupled with a refined classification of assets, a new format could significantly improve the utility of DOD financial statements.

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