



It's Time for Sovereign Governments to Practice What They Preach

by Hon. David M. Walker, Former US Comptroller General | May 20, 2014

Political leaders and regulatory agencies in various countries and supra-national entities spend a lot of time focusing on the need for quality financial reporting by public companies. At the same time, current financial reporting by sovereign nations and other political subdivisions (e.g., states/provinces, municipalities) leaves a lot to be desired.



As a CPA and a former Comptroller General of the United States, I know that the financial condition of most government entities is much worse than advertised. For example, in the US, the balance sheet does not include several trillion dollars of actual government debt related to current social insurance programs. In addition, the unfunded obligations related to certain social insurance programs (i.e., Social Security and Medicare), which are not on the balance sheet, are multiple times greater than the debt and other liabilities that are on the balance sheet.

I have also seen how many government entities try to distort the facts in an attempt to deceive people about their budget status and financial condition. Some egregious examples include:

- Considering the proceeds from a debt offering as revenue in cash based budget reporting.
- Deferring pension plan contributions and calling it a spending cut when, in fact, it is a deferred spending increase.
- Delaying payment of current obligations or accelerating revenue attributable to future periods.
- Using one-time revenues (e.g., grants) as a basis to make multi-year commitments.

Accrual-based financial statements, a budget reconciliation statement, and an appropriate stewardship statement can help to reduce "expectation gaps" resulting from the above type practices. Clearly the status quo is unacceptable and unsustainable.

The time has come to modernize government financial reporting in a manner that doesn't just focus on today but also tomorrow. Some examples of needed high-level financial reporting improvements in government that are applicable on a global basis include:

- Requiring adoption of generally accepted international accounting and reporting standards that could be supplemented by additional domestic disclosures, as and if applicable domestic standard setters and regulators deem it necessary.
- Requiring full accrual-based financial reporting.
- Requiring a financial statement that reconciles any alternative basis of accounting used for budget purposes (e.g., modified cash) with the full accrual-based financial statements.
- Requiring a stewardship financial statement that projects the likely financial and inter-generational implications of current government policies, programs, and fiscal policy.

The truth is many governments have grown too big, promised too much, and are in need of fundamental restructuring. This is especially true in connection with many social insurance and public retirement programs given current demographic trends. As has been in the case the private sector, improving current financial reporting will likely serve to accelerate needed transformational changes to existing social insurance programs, other spending practices, and tax policies.

While additional financial reporting improvements are needed, government annual reports should also be expanded to include more performance reporting. For example, taxpayers deserve to know what type of outcomes are being achieved by the government's combined spending tax and regulatory actions as compared to related goals and other comparator entities (e.g., countries, states/provinces, municipalities).

It's time for governments to move from laggards to leaders in connection with financial reporting. This change is necessary to provide more useful information for both investors (e.g., bondholders) and taxpayers. It is also necessary to help avoid unexpected crises today and help prepare for a better tomorrow.