FINANCIAL MANAGEMENT: THE ROLE OF GOVERNMENTAL ACCOUNT, GOVERNMENTAL AUDITING, AND INFORMATION SYSTEMS

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Introduction

Financial management is simply "the ways and means of managing money" (MacMenamin, 1999, p. 9). The objective of this paper is to develop a clear definition of financial management and to explain the roles of governmental accounting, governmental auditing, and information systems. An overview of the processes and core activities of financial management will be given in order to establish an integrated financial management concept. Concepts related to developing an integrated financial management approach in the public sector will also be illustrated.

Financial Management

Financial Management is defined as the determination, acquisition, allocation, and utilization of assets / financial resources, usually with an overall goal in mind (MacMenamin, 1999; Van Horne & Wachowicz, 2001) . From this definition, it can be concluded that financial management deals with the functions of investment, financing, and asset management (Andrew & Gallagher, 2003; Keown, Martin, Petty & Scott, 2002; Van Horne & Wachowicz, 2001).

MacMenamin (1999) further develops this definition by stating specifically that financial management is about: "analyzing financial situations, making financial decisions, setting financial objectives, formulating financial plans to attain those objectives, and providing effective systems of financial control to ensure plans progress towards the set objectives" (p. 9).

MacMenamin, (as seen in Figure 1), proffers that financial management is concerned with analysis, decision-making, planning, and control. The key ingredient in these interrelated activities is financial data and information. Reliable and relevant information (both qualitative and quantitative) and sound managerial judgment are the keys to successful decision-making. Therefore, the quality of the information used and processed, and the professionalism of the financial manger are determining factors in financial analysis, decision-making, planning and control. Financial analysis and review refers to the process by which managers evaluate and review the current financial situation of an organization, and based on this review, make decisions, objectives and strategies (Andrew & Gallagher, 2003; Keown, Martin, Petty & Scott, 2002; MacMenamin, 1999; Van Horne & Wachowicz, 2001).

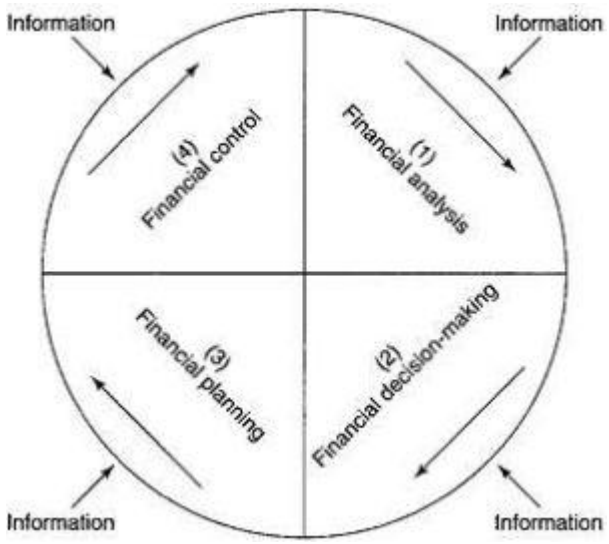

Figure 1: Financial Management Process (MacMenamin, 1999, p. 15)

Financial planning is the tool that makes the achievement of goals and objectives possible. An example of a key financial planning tool is the budget. The essence of financial

planning is to plan the allocation, coordination, and prioritizing of human capital and financial resources, e.g., to ensure that financial resources and input are available for the good or service that will be provided. The final stage is financial control, which ensures that all activities and strategies are in accordance with the overall plan, consisting of accounting, reporting and control management system(s) (Andrew & Gallagher, 2003; Keown, Martin, Petty & Scott, 2002; MacMenamin, 1999; McKinney, 1986; Van Horne & Wachowicz, 2001).

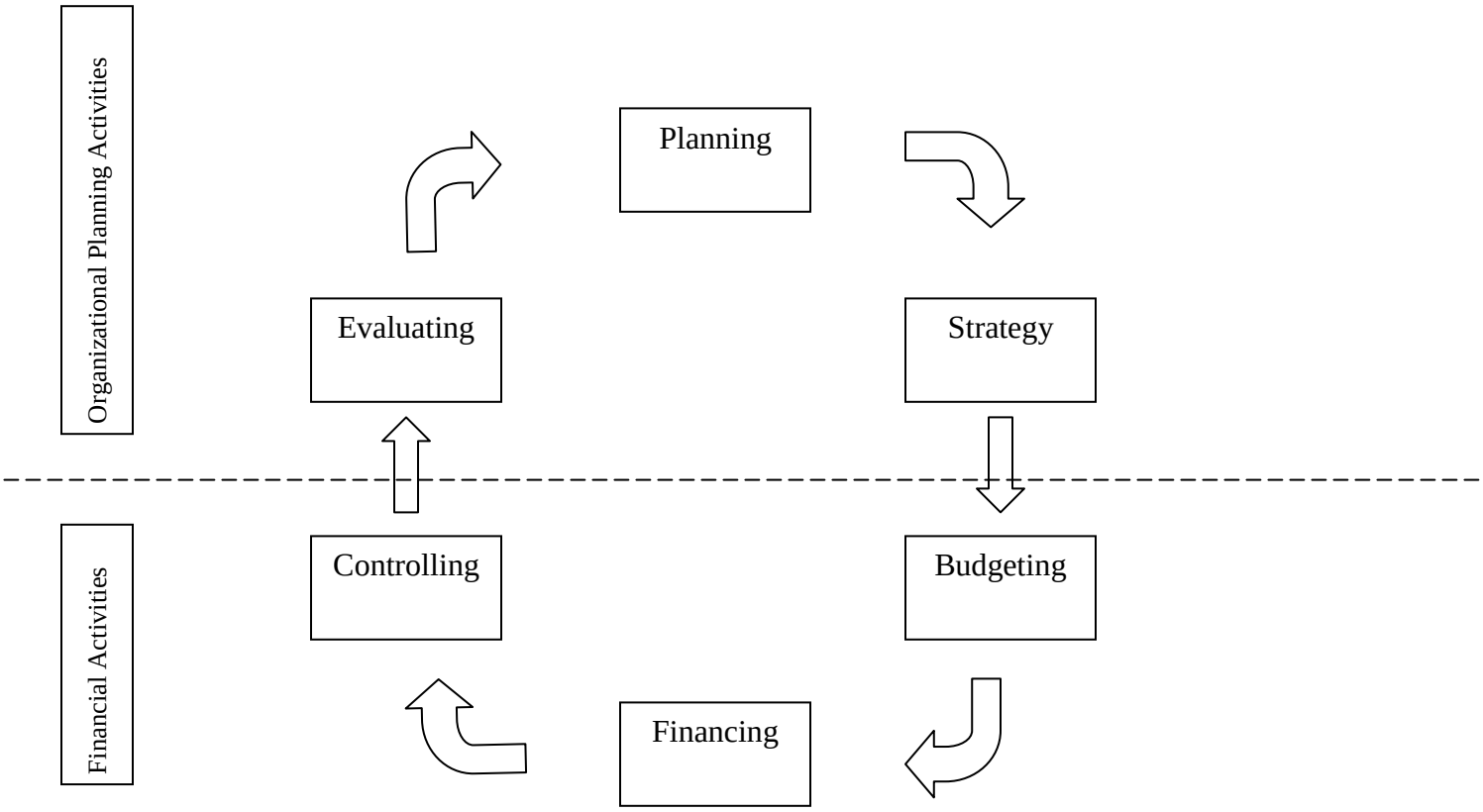

Figure 2: Components of an Integrated Financial Management (McKinney, 1986)

McKinney, (as seen in Figure 2), expands the definition of financial management to include not only financial activities and processes, but also management activities, with both

processes depending on the financial administrative system. He further defines these two processes into six sequential components: 1) planning, 2) strategy, 3) budgeting, 4) financing, 5) controlling and 6) evaluation. Each component will be explored and illustrated by applying the financial management process to the public sector. "The objective of financial management in the federal government is to assure that, to the maximum practical extent, the resources entrusted to it are acquired and used lawfully, efficiently, and effectively" (McKinney, 1986; US General Accounting Office, 1985, p. 2).

Planning

Planning is the first step and establishes the mission, vision, values, goals, and objectives that will be pursued. Planning is essential to the overall functionality of public organizations, which are established by the policy makers via ordinance / statutes as a remedy to address identified public policy problems. Therefore, the organization's mission will be shaped by the way the policy makers: 1) assess the nature of the identified social problem; 2) define and structures the policy problem, i.e., conceptualize the problem in a structured manner; 3) evaluate possible remedies and outcomes, and 4) formulate the preferred methodologies / strategies to deal with the public policy problem (Dart, 2000; Dunn, 2004; Freeman, Rossi, Wright, 1979; McKinney, 1986; Owen, 1993; Petheram, 1998; US General Accounting Office, 1985).

Strategy

Strategy translates the values and mission of the organization into detailed and measurable goals and objectives to be achieved within a specific time-frame. For example, Congress not only sets goals, but "set out year targets for spending and revenue levels" (US General Accounting Office, 1985, p. 10). Public organizations / agencies develop their plans and strategies to cater for a specific target population to achieve the desired goals and mission. In

order to set goals and objectives, the client base must be analyzed to identify the needs. A 'needs assessment' is essential to determine the client base. After identifying the needs that are to be met, goals, objectives, and strategies can be developed to satisfy the same through the implementation of appropriate programs (Freeman, Rossi, Wright, 1979; McKinney, 1986).

Budgeting

Budgeting is the mechanism that makes it possible to achieve these goals and objectives via allocation, coordination, and prioritizing between the services needed and resources available. A budget is an excellent planning tool because it articulates the services that should be delivered and the means to provide for them. The budget is needed to fulfill the mission of the public organization and meet objectives within the ordinance and / or statute, as it provides the following: 1) allocation, coordination, and prioritization between services needed and resources available for them, i.e., dividing scarce resources for the programs and services that need it; 2) a benchmark and instrument for monitoring performance measures and objectives; and 3) a mechanism for accountability, i.e., to determine whether the government is doing their job, in other words, making the government is accountable to the people / citizens (Hyde, 1992; Kerwin, 2003; Lee & Johnson, 1998; McKinney, 1986; Rubin, 2000; US General Accounting Office, 1985).

The budgetary process is essential for public organizations as it is an ongoing process in which the government is constantly reviewing and updating goals, objectives, and strategies. The process can be seen to have the following characteristics: 1) the 'planning component', which establishes direction and assists in resource allocation and availability (A budget assists in allocating and coordinating resources available to the needs identified. Since the resources available are limited, a budget assists in prioritizing the resources to the needs.); 2) the 'budget

preparation', which consists of determining revenue sources (i.e., collective, individual, etc.), forecasting expenditures, performance measures, and benchmarks; 3) the 'authorization stage', in which the governing body reviews and discusses the budgetary information and then passes appropriation ordinances and statutes; 4) the 'apportionment process', which is the execution of funds; and 5) the 'audit', which is to ensure compliance by agencies and organizations (Hyde, 1992; Kerwin, 2003; Lee & Johnson, 1998; McKinney, 1986; Rubin, 2000; US General Accounting Office, 1985).

Financing

Financial resources facilitate and make possible the achievement of the desired outcomes detailed in strategic plans, goals, and objectives. Financing is another form of generating the funds needed to provide goods and services, and is a substitute for taxing citizens. Financing consists of short-term, obligations that are due within one year, and long-term, obligations that are expire after one year. In the public sector, debt financing is either classified, by the purpose of the spending, as current or capital. There are various examples of financing for government including tax anticipation notes, revenue anticipation notes, bond anticipation notes, general obligation bonds, revenue bonds, and industrial bonds. The type of financing option pursued depends on the performance of the public organization / agency, its capacity to obtain more debt, its ability to pay its obligations, the purpose for the financing and analysis of the costs and benefits (Hyde, 1992; Kerwin, 2003; Lee & Johnson, 1998; McKinney, 1986; Rubin, 2000; US General Accounting Office, 1985).

Controlling

"Controlling assures that the activities planned and programmed are carried out according to the detailed pre-established work plan" (McKinney, 1986, p. 3). The major functions involved

are accounting, auditing, reporting, and purchasing. Accounting is the essential function and process that ensures that all activities and strategies are carried out in accordance with the overall mission, goals and budget of the organization. The functions of the accounting department are: 1) to ensure compliance with budget figures and performance measures; 2) to establish the mechanism of providing information; 3) to provide reports of results (which are excellent tools for planning and accountability); and 4) to ensure compliance through auditing (Kattelus & Wilson, 2004; McKinney, 1986; Ruppel, 2005).

In the public sector, the fund is the basic accounting entity. The concept of fund is basic to governmental accounting. A fund is defined as a "fiscal and accounting entity with a self balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changing therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations" (Ruppel, 2005, p. 54). In other words, government assets and liabilities should balance and funds should be used for the purpose that they where given for. The objective of fund accounting is to assist government in accountability and demonstrating compliance with the use of the public resources according to ordinance. There are three type of funds: 1) fiduciary, 2) proprietary and 3) governmental (Kattelus & Wilson, 2004; Ruppel, 2005).

Fiduciary funds are mainly "other people's money", such as employee's pension plans, investment trust funds, and agency fund, and disclosed in the following statements: statement of fiduciary net assets and statement of changes in fiduciary net assets. These are reported separately, as the governmental unit cannot use these to finance its day-to-day operations. It discloses the change in net assets (i.e., decrease or increase in the difference between assets and

liabilities) to determine the financial health of the fund, i.e., whether the fund is improving or not (Kattelus & Wilson, 2004; Ruppel, 2005).

Proprietary Funds, related to business activities, have two funds, the enterprise fund and internal service fund. Services that are charged are recorded in the Proprietary Funds Statements, i.e., the statement of net assets, statement of activities and statement of cash flow. Also, the public can see the cash flows of the funds and see whether their governmental unit supplies others (Kattelus & Wilson, 2004; Ruppel, 2005).

The role of governmental fund accounting is to "show that resources (restricted or unrestricted funds) have been used in accordance with authorized purpose" (McKinney, 1986, p. 35). Governmental funds account for general governmental activities including: 1) 'Special Revenue Fund' which accounts for proceeds from special tax revenue / grants that need to be used for a specific purpose; 2) 'Debt Service Fund' which accounts for "financial resources segregated for the purpose of making principal and interest payments on general long term debt" (McKinney, 1986, p. 35); 3) 'Capital Projects Fund' which accounts for acquisition and constructions of major capital projects; 4) 'Permanent Fund' which accounts for "permanent endowments created when a donor stipulates that the principal amount of a contribution must be invested and preserved but earnings on amounts invested can be used for some public purpose" (McKinney, 1986, p. 36); and 5) 'General Fund' which is the main operating fund that includes all current financial resources that are not specified in the above funds or other specific funds (McKinney, 1986; Ruppel, 2005).

The function of the Governmental fund is to account for all inflows and outflows of the current financial resources within one year; thereby, reporting on their accountability and demonstrating the governments' financial compliance. Governmental Funds are reflected in the

Governmental Funds Balance Sheet and Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances. The Fund Financial Statements focus on major funds. It is required by GASB 34 that each major fund be represented in a separate column. This is done in this way in order to represent the major interest of the external users. Non-major funds are grouped in other governmental funds, therefore, providing external users the additional information needed to understand the detailed financial performance of the government entity (McKinney, 1986; Ruppel, 2005).

According to the General Accounting Office (1985), "The usefulness of financial reports is increased when the information reported in them is consistent and reliable. The path to reliable information lies in effective budgeting, accounting, and related internal control systems, but the effectiveness of these systems must be assessed periodically to assure continued data reliability. Annual audits are generally regarded as the best way to accomplish this reliability" (p. 52). Auditing is the process by which the auditors analyze and review the basic financial statements and state an opinion on the basic financial statements, i.e., if they comply with generally accepted accounting principles (GAAP). The auditor needs only to audit the basic financial statements and has sole responsibility for this. His / her opinion is solely on these statements. This does not include supplementary information. Combining statements may be audited, only if they are stated by the government before the start of the audit (Kattelus & Wilson, 2004; McKinney, 1986).

Auditors need to state that the purpose is to determine whether the financial statements are 'free from misstatements'. They also need to detail their work plan and show that they conform to the standards of fieldwork under GAAP. They need to demonstrate an understanding of internal control structure and the ability to obtain evidential matter to support findings. "Their

report should include the procedure and outline of the audit, i.e., to: 1) examine evidence supporting the amounts and disclosures in the financial statements; 2) assess the accounting principles used and the significant presentation; and 3) evaluate the overall financial performance" (Kattelus & Wilson, 2004, p. 411).

In the public sector, the audit standards that need to be followed are the Generally accepted government auditing standards (GAGAS). The additional purposes of government auditing is to: 1) examine fiscal compliance, i.e., whether the public resources are managed according to purpose for which they are given; 2) assess financial and fiscal performance, i.e., whether the programs are achieving their goals and objectives and providing the service efficiently; and 3) overall accountability and management control of public resources. Therefore, audits are essential functions in providing feedback on the whether all the activities and strategies are carried out in accordance with the overall mission, goals, strategies and budget of the organization (Kattelus & Wilson, 2004; McKinney, 1986).

Evaluating

The evaluation of activities and results is also essential to determine whether the organization is complying with its overall goals and objectives. Managers evaluate the current situation of the organization by analysis and review. Performance indicators are an essential tool as they inform managers on the efficiency and effectiveness of the program. It is also essential to compare actual results with budget goals and objectives, and understand why there is a variance between the two. Recognizing the reasons behind the failures and success allows management to formulate new goals, or modify goals and objectives, and to establish a modified strategic plan (Andrew & Gallagher, 2003; MacMenamin, 1999; McKinney, 1986; US General Accounting Office, 1985; Van Horne & Wachowicz, 2001).

According to the General Accounting Office (1985), "evaluation provides feedback on the effectiveness of government-financed policies, programs, organizations, projects, and activities, and on whether, how well, and how efficiently they are achieving their intended objectives. Evaluation feedback is used by government managers, policymakers, and the public to: determine the effectiveness of a government initiative; judge the degree to which the government has achieved the intended objectives of its policies, organizations, programs, projects, and activities; supervise (oversee) the performance of the government and its officials and hold official accountable for producing desired results; and support future planning, programming, and budgeting decisions" (p. 52). Therefore, evaluating organizational planning and financial activities allows management to assess performance and set direction and formulate new goals, or modify goals and objectives and to establish a modified strategic plan (McKinney, 1986).

Management Information Systems

To further develop McKinney's definition, financial management should not only include both management and financial activities, but also include an integrated administrative and information system. As seen in Figure 3, an integrated management information system is the process in which data of the day-to-day transactions / operations are recorded or entered into the computer system and later ordered, converted and compiled as information to aid management decision making subject to professional / managerial judgment. The purpose of the system is to provide a thorough database (storing and maintaining data and transactions) which allows management to monitor, control and solve day to day operations and problems by providing timely information when needed, therefore, facilitating managers to respond to the needs of the organization and achieve their objectives and goals. Performance information is necessary in the

analysis of financial and management activities and the achievement of the measurable objectives and assists managers in the evaluation process. Ideally, the management information systems should implement the six components of planning, strategy, budgeting, financing, controlling, and evaluating, in order to have all the data necessary to convert to information for decision-making (McKinney, 1986; US General Accounting Office).

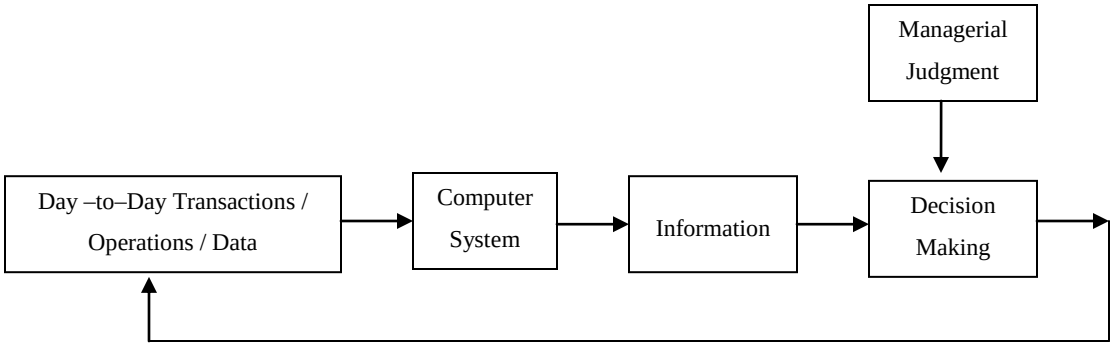

Figure 3: Integrated Information System (McKinney, 1986; US General Accounting Office, 1985)

According to the General Accounting Office (1985), the "key to the success of any information system is the data available to the system. In the corporate environment, data has become just as recognized and valuable a resource as personnel and capital resources. The value of accurate data is no less important to the successful operation of the federal government than it is to large corporations. The federal government shares with business the characteristics required of financial information to monitor and control operations. Although the technical terms and procedures may differ, information must be provided to: predict economic conditions/events;

establish budgets; monitor compliance with budgets; determine costs of operations; and compare expectations to actual performance" (General Accounting Office, 1985, p. 59)

Conclusion

Adapting all of the concepts and principles discussed, financial management is a decision-making process concerned with a series of interrelated financial and management activities based on an efficient and effective management information system. Reliable and relevant information is the key ingredient for these components which are: 1) Planning, i.e., setting of mission, goals and objectives; 2) Strategy, the translation of goals to measurable activities; 3) Budgeting (financial planning); 4) Controlling, the assurance that the planned activities are in accordance with the goals and objectives via activities such as accounting and auditing; and 5) Evaluating, the process of assessing whether the goal and objectives have been achieved.

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