

caused by price surprises, demands for service, supply problems, or alternative uses of resources in providing the service. There should not be a variance because the agency changed its basic service provision plan, however. The figure is for an agency that sells its services, so its variance report includes revenues as well as spending. A governmental department would not be expected to have that component because revenue collection is done by a department specializing in that work.

Governments establish special rules within which their agencies may move funds around in response to conditions not foreseen when appropriations were made. At the federal level, *reprogramming* is the use of funds within an appropriation account for purposes other than those contemplated at the time of appropriation. Consultation between the agency and the appropriate substantive and appropriation committees of Congress usually precedes the action, which may involve formal notification and an opportunity for disapproval by the committees. *Transfers* move all or part of budget authority in an account to another account or subdivision of an account (e.g., moving funds from Operation and Maintenance to Personnel). Such changes require statutory authority, although some agencies have transfer authority within an established percentage or absolute limits.¹⁶ State and local governments have similar, although often less formal, procedures. Often states establish interim committees to provide needed flexibility during periods of legislative recess, a vital adjustment feature where the legislature meets only periodically. Executives of nonprofit organizations would usually have considerable flexibility, although major shifts might require discussion with a board of directors.

Internal Controls

Program managers are obviously concerned with delivery of services according to plan. Financial managers are simultaneously concerned with maintaining internal control, defined as the methods and procedures within the agency established to safeguard assets, check the accuracy and reliability of financial and other data, promote operational efficiency, and encourage adherence to the prescribed policies and procedures of the agency.¹⁷ Internal controls represent the first line of defense against fraud and corruption.

Some basic steps in establishing internal control include the following:¹⁸

1. **Provide qualified personnel, rotate duties, and enforce annual leaves/vacations.** This policy ensures capable handling of tasks and ensures that irregularities can be found when new staff take over tasks on rotation or on temporary assignment. Every person involved in financial operations

¹⁶ General Accounting Office, *Budget Reprogramming, Department of Defense Process for Reprogramming Funds*, GAO/NSIAD-86-164BR (Washington, D.C.: General Accounting Office, July 1986).

¹⁷ Paul E. Heeschen and Lawrence B. Sawyer, *Internal Auditors Handbook* (Altamonte Springs, Fla.: Institute of Internal Auditors, 1984), 36.

¹⁸ The federal standards for internal controls appear in OMB Circular A-123, available on the OMB website. Internal control checklists are easily available from many organizations.

should be required to take a vacation of one week each year so that another employee will be in a position to see fraudulent activities. Personnel who are required to work beyond the limits of their capabilities are dangerous because they hold employment more tenuously and are thus more susceptible to requests for inappropriate actions.

2. **Segregate responsibility.** Dividing related duties and operating responsibilities among two or more qualified people reduces the chance of error or fraud by providing checks and balances on work performed. The bank statement must be sent to and reviewed by a person who does not have check signing authority. If the entity issues credit cards, statements must be reviewed by a person other than the ones using the cards and credit cards outstanding have to be closely controlled.
3. **Separate operations and accounting.** Divide the responsibilities for operational transactions (purchasing, receiving, collecting, etc.) from maintenance of accounting records to reduce chances for error or theft. Maintain a separate reconciliation of transaction records.
4. **Assign responsibility.** This ensures that tasks are performed and that the appropriate party in questioned transactions can be identified.
5. **Maintain controlled proofs and security.** Maintain segregated bank accounts and closely control cash and negotiable documents. Issue sequentially numbered receipts for collections, and avoid cash payments as much as is feasible. Make orders only from numbered and controlled standard purchase orders. Make payments only according to standard separate authorizations, and require bonding for any employees with access to significant amounts of organization funds. Require dual signatures on checks so that no single person in the organization can write a check. Regularly review and test internal control systems. Mark invoices as "paid" as soon as payment is made.
6. **Record transactions and safeguard assets.** Promptly record and accurately classify events and transactions. Limit access to source records and government assets to authorized individuals. Immediate deposit of receipts with "for deposit only" endorsement, daily list of all deposits, separation of responsibility between person who has custody of deposits and person who records them.

These steps can help implement the internal control standards of the International Organization of Supreme Audit Institutions, of which the Government Accountability Office is a part: documentation, prompt and proper recording of transactions and events, authorization and execution of transactions and events, separation of duties, supervision, and access to and accountability for resources and records.¹⁹ These control devices can reduce the chances of theft, error, and fraud. Although they offer no protection against poor public choices, they can help ensure

¹⁹Internal Control Standards Committee, International Organization of Supreme Audit Institutions, *Guidelines for Internal Control Standards* (June 1992), 9.

that choices get executed as they have been made, for better or worse. So many instances of theft from government could have easily been prevented with the most rudimentary system of internal controls.

An Intra-Year Cash Budget

A cash budget is a detailed translation of the enacted budget into revenue and expenditure flows through the operating year. It yields a forecast of disbursements, receipts, cash balances, and needs for financing over the budget period, taken at regular points throughout the year. It is based on likely (or known and controllable) patterns.

1. The pay cycle for employees is known, as are the wage-and-salary commitments in the enacted budget. From that information, the payment amounts can be forecast throughout the year—employees will be paid agreed amounts on certain days of the month throughout the year.
2. The pattern of payments to suppliers (contractors, utilities, etc.) is established, along with the budgeted amounts of those payments.
3. Large payments—payments of principal and interest of debt or purchases of large equipment—are in the adopted budget and are known in advance. Purchases of some large-ticket items may even be controlled within the budget year, so that payment is made shortly after large revenue inflows, not shortly before, to ensure that sufficient cash is on hand without any need for short-term borrowing.
4. Tax and charge revenues are usually driven by regular seasonal patterns. Collections are high in some months and low in others because of the fluctuations of economic activity within the year (high season and low season for some industries, due dates for quarterly payments, etc.). For instance, analysis of data from several recent years might show that sales tax payments received in January are typically 8.5 percent of the annual total. With these patterns known, the revenue forecast for the budget year can easily be translated into its likely monthly flow. Multiply the total sales tax forecast for the entire year by 8.5 percent to get the expected collections in January and so on through the rest of the months.

The cash budget is helpful to execution of the annual budget because it shows when the government might not have sufficient funds to cover the bills coming due at particular points during the year. That warns when the government might need to arrange a very short-term loan from local banks to tide it over the cash shortage and may allow the government to adjust some flows in or out to avoid the need for such a loan. That would save the interest that otherwise would need to be paid on the loan. Preparing such an estimated cash budget is a helpful practice for government fiscal officers. Furthermore, careful estimation of the payment outflows can be helpful in establishing allotment patterns for dividing the annual appropriation for individual agencies.

Audit and Evaluation

When the budget year is over, several questions should be asked. One basic question is whether the budget was executed as it was passed. The adopted budget should reflect priorities for government expenditures and the intentions for funding that spending. If the budget was responsibly developed and became, by legislative action, the legal fiscal plan, then it should be executed intact, subject to emergency changes beyond accommodation within the enacted budget.

A first key check is to establish that the executed budget and the adopted budget do coincide. Did spending occur according to plan or did it have to be reduced because of revenue shortfalls? Do the plans reflected in the budget match actual expenditure patterns at the close of the year? If they do not, have appropriate procedures been followed during execution to make the changes? In other words, the budget law must be followed if the budget process is to be meaningful in terms of legally adopted plans to be executed. This highlights the need to make sure that, during execution of the budget, expenditures get accounted for properly. For instance, an agency likely has more than one budget account to administer—for example, an account for central office administration and another one for field delivery of services. As the agency works through the year, it will spend from both accounts. It is important that, when payments get made, the accounting system takes payment from the proper account—the telephone bills for the field get paid from the field account and not the central account, for instance. A correct accounting is necessary to keep operations in line with the adopted plan reflected in the budget, prevents illegal movement of funds from one account to another, and provides a sound information base for development of future budgets.

Other questions are asked through the external audit process. Many audits are conducted using a prescribed checklist of steps to establish uniformity in how several different auditors perform a class of audits. Much of the audit focuses on controls built into the systems of the agency. If the internal control/internal audit system operates satisfactorily, the external audit agency need not be concerned with tracing the body of individual transactions because the system produces substantial compliance. The audit does, however, test that system. Accounting controls prevent fraud and waste, ensure the accuracy of operations, ensure compliance with applicable laws, and promote adherence to stated policies (including legislation). The audit determines whether those control systems work. In their audit, examiners look for errors and abuses such as those listed in Table 3–2. Much of the audit employs statistical sampling to permit probabilistic inferences about the extent of error in the total record population. There is seldom reason to scrutinize all records.

What Audits Need to Prevent: Some Methods of Stealing from Government

Stealing from government is normally rare in the twenty-first century. A robust budget process, including strong internal controls, clear appropriations and fiscal

Table 3-2**Some Errors, Abuses, and Manipulations Sought by Auditors**

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- Year-end accounting manipulations that push revenues and expenditures from one year to the next to increase or decrease totals in the year
 - Unrecorded liabilities: commitments to vendors that are suppressed by withholding written agreements and purchase orders from the paperwork system
 - Overforecasting of revenues to keep tax rates down or spending up
 - Failure to reserve adequately for nonpayment of taxes
 - Miscalculation of utility, hospital, and other service bills
 - Unauthorized transfer of funds between appropriation accounts
 - Recording of grant receipts in the wrong funds
 - Use of a commingled cash account to disguise use of restricted funds for unauthorized purposes
 - Failure to observe legal requirements for review and approval of budgets
 - Failure to compile and submit financial reports to state and federal agencies punctually
 - Improper computation of state aid claims
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SOURCE: Peter F. Rousmaniere, *Local Government Auditing—A Manual For Public Officials* (New York: Council on Municipal Performance, 1980), 10 with revisions.

responsibilities, and capable external audit, usually keeps theft in check. (Waste is another matter.) Nevertheless, thefts from government do still happen and receive extensive publicity when they are discovered, and they do make headlines when they occur. It is worthwhile to review some of the methods that have historically been used to steal from government.

GHOSTING

Theft through phantom resources—receiving payment for resources not actually delivered—can take several forms. One method, the ghost employee, involves placing on an agency payroll an individual who does not work for that agency. The person receives pay, but provides no service. A second method is payment for supplies or services that are not delivered. Invoices sent by the firm show delivery, but the agency never receives the supplies or services. A third method is double payment for supplies or services. The services are performed once, but invoices show delivery of two shipments. Each method causes the government to pay for resources not delivered, and each artificially increases the cost of public service.

BID RIGGING

The procurement fix involves rigging bids on supply contracts. Suppose a section of highway is to be repaved. Potential suppliers would establish beforehand the bid winner and the winning price; other firms would submit noncompetitive bids. Firms would cooperate in the collusion because their turn to win would come on another project. The collusion increases the profits of the firms and increases the cost of

government. Government employees may or may not profit from the procurement fix, depending on the arrangements of the scheme.

HONEST GRAFT

“Honest” graft uses advance information or information known only to a small number of government officials to produce private profit for the individual employee. The reminiscences of George Washington Plunkitt, Tammany Hall leader of early twentieth-century New York City, describe the process:

There’s an honest graft, and I’m an example of how it works. I might sum up the whole thing by sayin’: I seen my opportunities and I took’ em.

Just let me explain by example. My party’s in power in the city, and it’s goin’ to undertake a lot of public improvements. Well I’m tipped off, say, that they’re going to lay out a new park at a certain place.

I see my opportunity and I take it. I go to that place and I buy up all the land I can in the neighborhood. Then the board of this or that makes its plan public, and there is a rush to get my land, which nobody cared particular for before.

Ain’t it perfectly honest to charge a good price and make a profit on my investment and foresight?²⁰

That profit measures the extent to which the honest grafter, through use of inside information, steals from the public by forcing excess payments for a resource. Honest graft may similarly involve acquisition or establishment of companies to do business with a government. Bid specifications may be written so that a company would be the only one qualified. Requirements for the commodity or service would be artificially increased for the enrichment of the government employee.

DIVERSION²¹

Public assets or the service of employees may be stolen for private use. Office supplies, equipment, gasoline, and so on are as usable for private purposes as for government activities. Public employees may be diverted to private uses, including construction or maintenance projects on property owned by government officials. Employees are sometimes used as workers in political campaigns while on government time—a special illegal advantage of incumbency. These activities involve straightforward stealing because individuals use assets owned by the government without payment. But there are other approaches: poor controls over the use of government credit cards can provide modern thieves a highly effective tool for diverting public assets far beyond the dreams of corrupt public employees of earlier years. Too many government credit cards floating in a local government represent an improvised explosive device waiting to be detonated in the local Wal-Mart, at least in figurative terms.

²⁰ William L. Riordon, *Plunkitt of Tammany Hall* (New York: E. P. Dutton, 1963), 3.

²¹ For good illustrations of how diversion and shoddy material approaches to corruption work, watch *Catch 22*, a 1970 movie based on Joseph Heller’s novel of the same name and pay particular attention to the work of First Lieutenant Milo Minderbinder.

SHODDY MATERIAL

Because low-quality supplies and materials can generally be delivered at lower cost than can higher-quality supplies and materials, government contract specifications require delivery of quality material. A contractor who provides lower-than-specified quality (shoddy material) can thus profit at public expense. The Chicago experience goes back to 1869 when city officials painted City Hall, but used cheap whitewash and pocketed the amount that would have been spent on more costly paint.²²

KICKBACKS

Public officials who have power to select who receives contracts to do business with governments, what banks receive public deposits, and who works for government agencies may profit by arranging for artificially high contract awards or artificial wage payments with a portion of that payment kicked back to the government official. The favored individual or firm receives higher than the appropriate price for the contracted service and thus is able to profit even after making the payment to the contracting agent. Also, legislators have opportunities to shape appropriation bills to include the goods or services sold by a particular vendor. Sometimes, the payment goes to the public official or a relative, or the business purchases something from the official or the legislator at an inflated and highly profitable price. Sometimes, the payment is in the form of giving a job to a relative of the official or the legislator. Sometimes, the payment assists the finances of the election campaign of that official or of that official's political party; in the language of the politics of the 2000s, the former is "hard money" and the latter is "soft money." Unfortunately, kickbacks and special deals seem to have become an important influence in American politics and policymaking.²³

Corrupt businesses in less developed countries and countries in transition to market economies use political power to steal in slightly different ways from those found in developed democracies. Johnson and Kwak summarize some standard approaches: "An emerging market oligarchy uses its political power and connections to make money through such means as buying national assets at below-market prices, getting cheap loans from state-controlled banks, or selling products to the government at inflated prices."²⁴ Transparency, regularized fiscal processes, and internal controls normally prevent such easy pickings in other nations, although they do remain a problem in subnational governments of the United States where unskilled government officials and inadequate systems make public resources ripe for picking.

²² "Corruption in Illinois: Where's Mine?" *The Economist*, June 6, 2015, 24.

²³ At one time, it was an accepted practice for firms interested in doing financial work for local governments to make significant financial contributions to local politicians before they were to be even eligible to bid for the work, a practice called "pay to play." Those requirements are now banned almost universally.

²⁴ Simon Johnson and James Kwak, *13 Bankers* (New York: Vantage Books, 2011), 133. Such purchases of government-owned assets, particularly involving natural resources, when the socialist economy was privatized was a source of the vast wealth of many of the "oligarchs" who are so important in the Russian economy.

The twenty-first century provides interesting new twists for corrupt behavior. For example, the finance director of the Los Angeles Memorial Coliseum put the purchase of new sound equipment for the government-owned facility on his personal credit card, earning a fabulous number of reward points.²⁵ Not only did the action violate procurement policy that forbade use of personal cards for major acquisitions, but also it raised questions about conflict of interest in choices made by the director, evaded financial controls for the jurisdiction, and probably caused the warranty on the equipment to be voided. Major purchases are done by purchase orders and checks, not credit card, because such payments are more readily controlled against unauthorized use of public funds.

Conclusion

Budget skills combine techniques that can be taught with a cunning that comes only with experience. The start for all budgets must be a sound understanding of what the agency request intends to accomplish. Without that foundation, no amount of tricks can help much. As in many government operations, the great problem is information—those who have that information and are able to communicate it have greater-than-average success. Beyond that, there are few general truths.

QUESTIONS AND EXERCISES

1. The data in the following table present revenues and expenditures by categorized type for the School of Public Affairs at Enormous State University. As with most elite programs at state universities, the school has accepted missions of teaching, research, and service to the university, state, and nation. The data include budgeted and actual data for three years and the proposed budget for fiscal 2014–2015. Your task as a budget analyst is to learn as much as possible about the operations of the school and its plans for the budget year just from these data. In particular, you should look for trends, changes in shares and ratios, and the categories that are particularly important in driving the finances of the school. A few notes about the reported data: First, the state appropriates money to the university and then the central administration distributes that money to the various operations on campus. That is the source of the state appropriation number—it has been assigned to the school, so this number for 2014–2015 is an actual. All others are part of the request. Second, the central administration charges the school for the services that it provides (central library, computer networks, etc.). This charge is the assessment number in the table. It is based on

²⁵Paul Pringle and Rong-Gong Lin II, "Coliseum Finance Director Earned Visa Points on Stadium Upgrade," *Los Angeles Times*, December 10, 2011. <http://articles.latimes.com/2011/dec/10/local/la-me-coliseum-20111211>