Critical Perspectives on Accounting

Volume 19, Issue 2, February 2013 Pages 222–254

Chinese Learning

Accounting scandals, ethical dilemmas and educational challenges

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Abstract

Whenever corporate fraud or accounting scandal occurs, a common feature will be irregularities in financial reports; this creates a lack of confidence and uncertainty and reduces the decision usefulness of such reports. It has been suggested that continuing revelations of accounting scandals involving America's iconic corporations have shaken investor confidence and the public perception of corporate and the accounting profession. Turner (2002) notes that the vitality of financial markets and economic activity rests on the profession's ability to restore confidence in the financial reporting system. A CBS News New York Times poll (cited in Paul, 2002) reported 7 in 10 respondents as saying, "the accounting and other practices that led to Enron's collapse are widespread in corporations" (p. 24). Why are such questionable accounting and corporate practices so widespread? What effect does this have on corporate values, culture and behavior? The Economist Intelligence Unit (EIU) claims that, "nearly a year after the Enron revelations first surfaced, corporate governance dominates the political and business agenda", that one disputes the need for transparency, honesty and accuracy on the part of corporation but questioned whether "the pendulum has swung too far?

The EIU white paper notes that concerns were raised among executives that hastily prepared regulations and overly strict internal procedures may impair their ability to run their business effectively. The Unit also notes that today's corporate turbulence may seem unprecedented, but that it has happened before. They cite 1.K. Galbraith's book, *"The Great Crash 1929",* which chronicled how an asset bubble bred lax accountability. The bubble's collapse exposed malfeasance as money became tight; this created a loss of investor confidence and public outrage that, in turn, prompted a hasty reaction by lawmakers and regulators. Imhoff (2003) maintains that serious problems exist today in accounting, auditing and corporate governance that undermine the quality and integrity of financial reporting. He writes that to attribute U.S. accounting failures to a deficiency in U.S. GAAP was totally inappropriate. He argues that U.S. GAAP represented the most comprehensive set of financial statement requirements in the world and that this therefore generated greater transparency in financial reporting than in any other country. Imhoff supports his argument by pointing out that accounting rules required implementation by managers to disclose the complex activities of a transaction which were subsequently reviewed by auditors. Importantly, he stresses that managers and auditors could always circumvent both bright-line and principles-based rules when they nc longer acted in the interest of shareholders.

Saravanamuthu (2004) suggests that the profession had deprioritised the public interest at a time when society sought responsible direction for sustainable business practices and life styles. The profession's alignment with commercial interests undermined its very status and relevance as a profession. She argues that "gold-collarism" (explained by Saravanamuthu as a term that Kelley in 1985 coined to signify the end of knowledge workers' struggle for control over the labour process), which includes accountants, draws attention to the "ethics versus profits" dilemma that the profession is embroiled in. She further states, "it appeared that the public interest role was abandoned for a more lucrative one of consulting-partner to the business community despite its presumed impartiality in transforming management's rules of engagement with multiple stakeholders" (p. 587). If decreasing confidence is placed in financial reports prepared and audited by the accounting profession, we need to examine why this is happening. The next section will reflect upon the corporate values and behaviour that come into play when managers, auditors and accountants no longer act in the interests of the public and shareholders/stakeholders.

2.2. Corporate values and behaviour

The situation regarding corporate values and behavior was aptly summarized by Higgs (in EIU, 2002 paper, p. 5): "The first thing in this game is that there are no absolutes. There are no blacks and whites. There is no such thing as getting it right-there is only behaviors that tend to improve the outcomes." An accounting analyst with Credit Suisse First Boston, Zion (in Tunick, 2002) says, "I think everyone's looking for black and white, and the accounting rules are not black and white"; furthermore, Zion claims that, "the overabundance of information and transaction types within GAAP creates confusion on how its rules should be applied" (p. 1). The EIU paper declares, "What's more, a key lesson from the Enron experience, where the board was an exemplar of best practice on paper, is that governance structures count for little if the culture isn't right" (p. 9). Tierney (in the EIU 2002 paper) explains, "Culture is what determines how people behave when they are not being watched" (p. 9). The crisis in corporate confidence can thus be attributed to lapses in personal and professional integrity, and their subsequent effect on accounting firms and their corporate clients (Adler, 2002). When such deficiencies are scrutinized and found wanting, the profession and offending corporations become villains. Korten (1998) postulates that the prevailing sentiment in business schools is that executives are to be trained to succeed in the world of business as it exists, not to change it. He adds that the best and brightest executives are being trained for careers in service to an economic system engaged in the systematic decapitalisation of people and planet to make money for the already very rich. This is a myopic ideology. Korten asserts that we need to create a system that makes power accountable to life, or money will destroy us. Therefore, Korten contends that serious attention is needed "from talented professionals who value people, nature, and our living planet more than they value money and people who have expertise in the design of large-scale behavioural systems" (p. 389). Young (2003) argues for moral capitalism, where private interests should be reconciled with the public good, public confidence can be restored, wealth created for all and poverty ended. A strong argument was put forward by Craig and Amernic (2002a):

> ... We contend that the very nature of corporatized capitalism as a social and economic phenomenon requires scrutiny because of the power and attendant mindset it bestows on key elites and the behaviors it imposes on many others. Therefore, even 'model citizen' corporations, especially the powerful ones, require permanent critique, since closer scrutiny may unmask some of the perceptual blinkers by which they were judged to be such 'model citizens'. (p. 143)

The above discussion raises issues of ethical behavior by participants embroiled in the ongoing business and accounting scandals. Should we not examine ethical values of the participants, if we want to improve stakeholder confidence in what we do? Could we, through education, influence participants' behaviour? Can they be taught and influenced on how to behave appropriately for the overall good of society? What is this elusive quality that will make us all winners in the world that we live in? People need to ask "what matters most?" (Korten, 1998, p. 389). It has been debated that what matters most is largely an internal contest about what values we hold versus what values we ought to hold and what society expects of the profession. Jones (1998) comments, "it is a war within each of us" (p. 20) and claims that there is a battle between our material desires and satisfactions and our deeper, possibly buried, convictions about nature and the integrity of creation. The high profile Martha Stewart case in America provides such an instance. Martha Stewart built a catering company into media empire oflifestyle magazines, cookbooks and television shows and yet chose to make an unethical and illegal decision that, one could argue, was about maximizing her wealth accumulation, realizing her material desires and gaining satisfaction. She was found guilty in March 2004 of conspiracy and making false statements. The 11 March 2005 Editorial of The Boston Globe observes:

> Stewart released from the facility in Alderson, W.Va., last week after serving five months for lying to federal prosecutors investigating the 2001 sale of ImClone Systems Inc. stock symbolizes America's ambivalence for honesty. She is seen by

> some as a queen of the culture of cheating, condoned because "everybody loves it." (p. A14)

In his investigation into the history of corporate collapses in Australia, from the first bank closure in the 1820s through the four great recessions of the 1840s, 1890s, 1920s and 1970s to the downfall of the house of Gollin, Sykes (1988) writes:

> Nor can we ignore the high incidence of fraud and dishonesty which has been chronicled in official reports and investigations. It is probably true to say that nearly every company in Australia is being plundered to some extent by its directors and senior management. The most frequent form is by falsifying expense accounts or charging items of personal consumption to the company's account. As long as the company stays healthy, with strong and genuine earnings, these practices can be tolerated as perquisites of office. (p. 551)

The norms of society contribute to corporate values and behavior that demands individuals put their material desires first; it is by the accumulation of personal wealth that the success of an individual is measured. The battle for material desires is therefore entwined with a prevailing and overriding culture that insidiously dictates our quality of life and how we live, without it in this modern society, we cannot survive: this is the money culture.

2.3. Money culture

Money makes the world go around, so we have been told. Without money we cannot have resources to develop and grow. Without money, we cannot have a comfortable life and some would like to have more than just a comfortable life! Right from an early age we are introduced to the idea of money and its importance in providing the things we need. Children are told that they cannot have good resources in their classrooms because their schools lack the money to buy them. Increasingly, they are involved in fundraising activities to fund these resources. They are given raffle books and other fundraising forms. Kindergartens hold dance-a-thons. Primary schools hold skip-a-thons. Forms have to be filled in by sponsors to indicate the dollar amounts that the children will earn for their institutions from these "fun" activities. Commercial organizations become involved early in our children' lives. The sponsoring of their products by schools, for example, photo shoots and pies, allow commercial organisations to get their money before giving the school a percentage of the proceeds. What is becoming increasingly apparent is that children now learn from an early age the "value" of money. Gallo (2001) writes:

> We are barraged with messages about money and values associated with money from toddlerhood to adulthood. For way too many children, the bulk of those messages are from the most sophisticated information delivery service ever invented: the modern marketing industry that inculcates the message that consumption is good and that he who dies with the most toys wins. (p. 46)

We argue that it is the importance of this money culture that we take with us as we grow up to become more active participants in the world. We are trained and conditioned from a very early age that money allows us to have things and that other matters become secondary.

It is of little wonder that peoples' values and behavior may become questionable when their sole purpose in life is devoted to acquiring money and its associated pleasures. We see this in the Chapman debacle where the gamekeeper had turned poacher. Chapman was a New Zealand auditor-general who appeared not to have enough money to spend. He was found guilty of using taxpayers' money to fund his personal expenses. On 11 August 1998, The Evening Post reported that this disgraced former auditor-general was penalized by ICANZ (now NZICA) for fraudulent activities. Another debacle that illustrates how money plays such an insidious role in our lives occurred in the **HIH** Insurance Company in Australia. The findings of the Royal Commission into **HIH,** Australia's largest corporate collapse, indicate that the founder and former **HIH** chief executive, Ray Williams, faced charges of misleading investors, giving away company money and keeping crucial information from the board. Clarke et al. (2003) write:

> What's a billion or two between corporate friends? The 1980s high priests of corporate finance, now the disgraced entrepreneurs, certainly had no qualms in lending hundreds of millions of dollars to each other. Revelations in the **HIH** Royal Commission indicate that little may have changed over the subsequent two decades - they refer to alleged corporate largesse with 'other people's money', in the form of a 'river of money' flowing from **HIH** just prior to its liquation. It was reported in the press that Counsel for the **HIH** Royal Commission alleged that CEO Ray Williams dished out millions of dollars on executive rewards, bonuses and funding to associates and charities prior to HIH's collapse. (p. 9)

Cahn (2000) writes, "[w]e are so immersed in a money environment that we can no more perceive how it shapes or affects our perception than a fish can imagine that water might distort the world it perceives" (website source, not paginated). It has been suggested that the worship of money has become our secular religion and that we live in an age where money talks and people listen (Lapham, 1988). One might ponder, all for what? Sykes (1996) illustrates the impact that the money culture has on people when he writes about Australia's corporate collapses:

> They were bold riders, all right. The corporate cowboys of the 1980s rode our financial landscape as none had done before. They used tiny equity holdings as the basis for huge empires built on debt. They took the savings of Australians, entrusted to our banks, and channeled them into takeovers on a scale that had never been seen before. (p. xv)

One has to reiterate, all for what? Sykes affirms the views held on the money culture when he comments:

> The Eldorado they sought came in many shapes. A mansion with rich furnishings and an art collection was de rigeur. It was usually supplemented by a country estate with equally rich fittings. There were private jets and luxurious boats, strings of racehorses and sleek, high-powered cars. Their wives wore diamonds and-in many cases-so did their girlfriends and mistresses. (p. xv)

As an interesting aside relating to the issue of money, but one which is more related to academic publishing than to the business environment per se, Tinker (2000) states, " money

Can't buy you love, but it can buy a piece of the editorial action of a prestigious journal like Accounting Horizons, especially when money materializes as academic labor power." (p. 58) Young (2003) brings out clearly the issues associated with money and power. He writes:

> There are times when we may sell our souls to gain what money promises in the way of power and license. This is especially true in today's culture of consumerism where we have sanctified appetite over character. Money enables us to do what we want. People seek it; they covet it; they even kill for it. Money provides us with discretionary power, easing our ability to tum people and their needs to our use. (pp. 136-137)

The issues dealing with money are reinforced by Korten (1998) who writes, "[o]ur present system makes power accountable to money rather than to life" (p. 389), and adds that because people confused the relationship between money and wealth, they have come to embrace policies and institutions that are destroying the real wealth of the planet and society to make money. Soros (1997) argues that people increasingly rely on money as the criterion of value. There is a perception that what is more expensive is considered better, that the value of art can be judged by the price that it fetches and that people deserve respect and admiration because they are rich. He states, "what used to be a medium of exchange has usurped the place of fundamental values" (p. 4). Furthermore, Soros (1998) writes:

> What I can say with confidence is that the substitution of monetary values for all other values is pushing society toward a dangerous disequilibrium and suppressing human aspirations that deserve to be considered as seriously as the growth of GNP. [...] Profit-maximising behaviour follows the dictates of expediency and ignores the demands of morality. Financial markets are not immoral; they are amoral. By contrast, collective decision making cannot function properly without drawing a distinction between right and wrong. We do not *know* what is right. If we did, we would not need a democratic government; we could live happily under the rule of a philosopher king as Plato proposed. But we must have a sense of what is right and what is wrong, an inner light that guides our behavior as citizens and politicians. (p. 208)

In addition, Soros asserts that what is happening in our society today is that our sense of right and wrong is endangered by our preoccupation with success being measured by money. It therefore appears that it is this money culture that entwines people into the vices of a capitalistic society.

2.4. Vices of a capitalistic society

So what are we up against? Cooper and Deo (2005) argue:

> The process of blame shifting and the rhetoric of attempting to prevent a recurrence of unexpected corporate failures such as One-Tel, Health International Holdings (HIH) in Australia and Enron in United States and Europe's Parmalat, inevitably ensure that the regulatory failures and reform cycle will continue to be "a never ending story". (p. 156)

We argue in this section that it is the vices of a capitalistic society that contribute to the never-ending nature of corporate and accounting scandals. Percy (in Bruce, 2002) is of the view that there are systemic reasons for corporate failure, based on behavioral issues. He indicates that there is a wider issue than just the reforming of accountants in a crisis. According to Percy, "a culture of integrity in business dealings" (p. 3) needs to be re-established. EIU (2002) white paper reports that, "in any case, corporate governance is about much, much more than the accuracy of the balance sheet" and "indeed, except in cases of rudimentary fraud, the balance sheet is just an output of manifold structural and strategic decisions across the entire company, from stock options to risk management structures, from the composition of the board of directors to the decentralization of decision-making powers" (p. 7). Senior management members focus on becoming leaders, in some cases world leaders, in their industry area. The desire to be a leader may tend to outweigh corporate social responsibility issues. Importantly, however, Smith and Smith (2003) contend that, "If you occupy a position of leadership then your actions profoundly influence those who follow your example", and cite General H. Norman Schwarzkopf's view on the leadership issue: "Leadership is a potent combination of strategy and character. But if you must be without one, be without strategy" (p. 7). We can only postulate that the strength and conviction of one's character will determine pertinent strategies. Kammler (2002) writes, "While we are talking of economic performance, another separate discussion is going on about the lamentable loss of our ethical values. Nobody seems to realize the two are connected or, even worse, that the unfettered free market economy is itself destroying our values" (p. 9). Citing Mumford, Kammler argues, "the capitalist scheme of values in fact, transformed five of the seven deadly sins of Christianity - pride, envy, greed, avarice, and lust - into positive social virtues, treating them as necessary incentives to all economic enterprise; while the cardinal virtues, beginning with love and humility, are rejected as bad for business" (p. 9).

Phillips (2002) reinforces this view when he notes that speculative markets and growing wealth also corrupt philosophy and ideology, reshaping them to justify greed and ruthlessness. According to Phillips, the 1980s and 1990s imitated the Gilded Age[1] (1878-1889) in intellectual excesses of market worship, laissez-faire and social Darwinism, and those notions of commonwealth, civic purpose, and fairness have been crowded out of the public debate. The privatization of telecommunications and energy entities into profit-making companies illustrate Phillips' argument adeptly. In the past, these entities were state-owned enterprises, providing essential services to society. Since their privatization and the adoption of a capitalistic business model, the focus of these companies has been to maximise their returns (profits), irrespective of the cost burdens on society. Media reports indicate the suffering of the elderly in the winter months because they cannot afford to turn on their heaters. Where is the notion of commonwealth, civic purpose and fairness from these companies? They inform the shareholders (and the government), whom they perceive to be

[1] The Gilded Age in the American history period saw the growth in industry that produced a lot of wealth for a number of businessmen like John D. Rockefeller (in oil) and Andrew Carnegie (in steel) who became known as robber barons; people who got rich through ruthless business deals. The Gilded Age got its name from the many great fortunes created during this period and the way of life this wealth supported. Information was sourced from the Library of Congress website: http://www.americaslibrary.gov/cgi-bin/page.cgi.

their main stakeholders, that their economic performance is below par if they are not generating millions of dollars surpluses. To obtain these surpluses, they argue that charges on consumers/society need to be increased. Of course, they would not present their arguments in such a manner. Explanations for such fee increases would focus on how onerous a cost it is to provide such essential services. They would argue that if charges were not increased then the quality of the services provided would diminish. However, the ulterior motive for such surpluses must be questioned, especially since society is hurting from such continually increasing charges.

It has been argued that genuine and sustainable reform has to come ultimately from within and not be legislated from outside. Googins (2002) points out that if corporate leaders commit themselves to an honest and deep self-reflection, they will recognize the downsides to the narrow brand of capitalism that has marked much of recent decades. Schwartz (2002) writes that the deeper, radical truth was that the Enron debacle epitomizes the dangers of the speculative "free market" mania that has resulted in deregulation and the gutting of the public sector in favour of the fool's quest for short-term profit. He also suggests that the other side of speculative profit is speculative bust, the costs of which fall on small investors and workers rather than on corporate executives who are routinely rescued by government bailouts and "golden parachutes". Schwartz further notes that the "Enron collapse is not a footnote to an otherwise healthy global capitalism" but rather that it was "another calamitous product of a deregulated financial system that places all the costs of corporate risk-taking on ordinary citizens and allows the speculative risk takers to get away with - for them - costless failure" (p. 7). Googins writes, "[what will win back our confidence in big business is not the sight of a chief executive behind bars, but a solid record of companies practicing good corporate citizenship" (p. E4). He explains:

> Years of working with hundreds of companies as they develop their citizenship strategies has taught me what citizenship is - and what it isn't. Corporate citizenship is not about how a company gives away money. It's about how it makes its money and how it manages its money. Good corporate citizenship is fiscal transparency, the demonstration of a corporate social conscience, and evidence that corporate values are more than pretty words on a framed plaque. Look at Enron. It had an ethics program, standard accounting practices and a code of conduct. It even invested $18 million in minority - and women-owned businesses in what was a truly laudable community economic program. Yet, all of that was choked off by corruption at the core of the company. (p. *EA)*

Why do corporate managers get involved in acts of corruption? Korten (1998) asserts that it is not because they lack morals or that they have no sense of right and wrong. He maintains:

> No. They do it because it is what they are paid to do and they work in a culture of capitalist ideology that says their job is to produce returns to shareholders - governments and society will take care of the rest. Furthermore, it is what business schools train them to do. (p. 395)

Pratt (2002), however, puts forward another notion:

Organizations can be portrayed as inherently evil, to be resisted and criticized at every turn. Or they can be seen as, for the most part, led by inherently good people who are doing their best to create sustainable wealth and well-being for people, organizations and society with a set of tools and ideas about managing and accounting which are grounded in modernity and ill-suited for a post-modem world. (p. 189).

In equipping accounting and business graduates with inappropriate tools and ideas about how organizations should operate in the post-modem world, it should come as no surprise that business collapses and accounting scandals continue to happen. Interestingly, Mintzberg, cited in Cowe (2002), says that while the current crisis of corporate honesty stemming from the collapse of giants such as Enron and WorldCom has highlighted the dangers of the US-inspired model of shareholder value, the issue was more fundamental than old-fashioned corruption. He explains that the problem was what he called "honest corruption" (p. 10) and that this referred to a system that allowed companies to damage society within the law and executives to amass untold riches, despite destroying value. This system of honest corruption, known as the "legalistic culture" (EIU white paper, p. 6), is a dominant and controlling factor that prevails in the complex world of commerce.

Fund Accounting Clinic

Amount of federal funds received and authorization of funds Obligations of funds

and un-obligated balances

Assets and liabilities

Program income

Expenses by grant year and program ***Time and***

Activity Reporting

As the largest single expenditure of SN APS funds, special attention must be paid to the documentation and reporting of staff time associated with SNAPS-eligible clients and activities. Most SNAPS-funded employees work on more than one activity and/or project (as demonstrated in job descriptions that list "other duties as assigned"). When an employee works on more than one activity and/or project, OMB's standards require:

Work must be supported with a time and activity tracking system

- System tracks actual time spent on a HUD-eligible activity

•System tracks activity that took place (who was the eligible client, what was the eligible activity)

· Documentation on the activity be maintained that supports the information in the tracking system

Time and Activity Records Are Based On Fund Accounting

Required time and activity records must comply with specific requirements. Time and activity records must be an after-the-fact determination of actual activity (therefore, one cannot have a pre-printed timesheet). All time and activity records must be signed by the individual employee who completed the actual work or by a supervisor who can vouch for the actual work.

According to OMB, time and activity records must be prepared at least monthly; although, keeping records on a daily or weekly basis is much more practical and efficient.

The signed time and activity records are used to determine actual salary expenses by tyingeligible SNAPS activities back to the approved budget.

OMB's requirements for reporting time and activity apply to direct HUD grantees, sponsors and service providers. All SNAPS grantees need to develop forms that comply with OMB's requirements. HUD's San Francisco Field Office has developed a template fortime and activity reporting that can be customized by a SNAPS grantee, as long as it complies with OMB's standards.

SNAPS grantees should have supporting documentation that ties the time and activity records to eligible clients and activities. Documentation that supports time and activity records may include such things such as clients' case notes, calendars, logs, sign-in sheets and dated reports.

Experience showns that many SNAPS grantees make mistakes in justifying time for federal reimbursement. Listed below are some of the most prevalent timekeeping mistakes:

Top 10 Timekeeping Mistakes:

1. Charging 8 straight hours per day to a grant (time 6. Not linking time to an eligible grant (or multiple reported must be actual and therefore one cannot grants) Charge 8 straight hours as it is probable that there might be other work assignments that occur during a workday)

2. Charging a fixed percentage of time to a grant (per- be allocated to a grant-centages may work to develop a budget but time reporting must be actual and therefore, time must be recorded when it happens)

3.Not using information from the time and activity re-cord to charge the grant.

4. Not including sick time and vacation (if these items are not include on the time activity record, it is not possible to allocate expenses to the proper accounts).

5. Not linking time to an eligible activity (If time is not linked to a HUD-eligible activity, it is not reimbursable with federal funds. It tray be charged to a non-federal source, but there must be a nexus between time charged and eligibility.)

6. Not linking time to an eligible grant (or multiple grants)

7. Not identifying a project and/or client (time that cannot be linked to an eligible project and/or clients not eligible for federal reimbursement because it cannot be allocated to a grant.

8. Not showing time spent on non-SNAPS activities(while HUD only reimburses for SNAPS-eligible activities, the time and activity record must show all work done to determine what time is eligible and what time is not),

9. Not having supporting documentation to substantiate time expenses (without supporting documentation, an employee may have worked but since it cannot be substantiated their time cannot be reimbursed with federal funds).

10. Not getting the time sheet and activity record signed (A time and activity record is not complete until it is signed by the employee.)

OMB has slightly different requirements for timekeeping systems depending on whether the grantee is a nonprofit organization or a governmental entity. In Circular A-122 (which applies to nonprofit organizations) Attachment B, paragraph 8.m(1) states that "charges to award fur salaries and wages ... will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages will be supported by personnel activity reports, as prescribed in subparagraph (2), except when a substitute system has been approved in writing by the cognizant agency." In subparagraph (2)(c) the standards require that personnel activity "reports must be signed by the individual employee, or by a responsible supervisory official having firs t hand knowledge of the activities performed by the employee .... "

In Circular A-87 (which applies to governmental entities) Attachment B, paragraph 8.h. states that "charges to Federal awards for salaries and wages ... will be based on payrolls ... and approved by a responsible official of the governmental unit" and further that "personnel activity reports ... must be signed by the employee."

Allocating Costs

The unique nature of fund accounting has important implications for financial management in the not-for-profit sector. The allocation of funds in profit-oriented organizations reflects management perceptions and interests; as corporate priorities change, budgets can be revised and funds reallocated between projects. This provides great flexibility for the for-profit organization to handle changes. In the public sector, allocations are restricted by laws or contracts and expenditures may only be incurred if authorized for the designated purpose of the funding agency.

The terms and conditions of the SNAPS grant agreement limits the use of HUD funds to eligible costs that are reasonable, allowable and allocable to the grant. Therefore, not all costs are reimbursable even if they are HUD, homeless or SNAPS funds. To be reimbursed in the proper manner, SNAPS funds must be associated with a specific "fund account".

In the SNAPS program, a specific fund account needs to be established for each SNAPS award, even if a grant is being renewed. Unless HUD has specifically approved a grant consolidation, each SNAPS grant is independent of each other and cannot be used for any other SNAPS project. This logic follows all the way through to the Annual Progress Report that requires a report for each individual SHP grant.

SNAPS Expenses Must Comply With Federal Cost Principles Costs are only eligible for federal reimbursement if the costs are associated with an eligible client Pay for eligible activities under the funding program.

Are delineated in the application (budget) Have adequate

source documentation Meet OMB standards for being

reasonable, allowable and allocable

When SNAPS costs are ineligible, say because of an ineligible client, all costs associated with that client - including match and administration - are ineligible. All SNAPS-eligible activities must be delineated in an approved budget. Just because the program's desk guide says that something "might" bee legible, the activity actually becomes e ligib le when it is in an approved budget and meets the cost principles laid out by OMB.

OMB Circular A-87, Cost Principles for State, Local and Indian Tribal Governments and OMB Circular A-122, Cost Principles for N on- Profit Organizations, set forth guidelines for what constitutes reasonable, allowable and allocable costs. When costs are charged to a federal award they must be necessary, reasonable and directly related to the grant.

Cost Reasonableness

For SNAPS costs to be considered reasonable, a determination must be made as to:

· Whether the cost is ordinary and necessary (for instance, one might need to conduct a cost-benefit analysis to see if the cost is reasonable)

· Market prices for comparable goods and services (requires that SNAPS grantees follow procurement standards and compare costs to each other)

· What benefit is provided to the individuals to be served by the expenditure

SNAPS grantees should be sensitive to the fact that federal funds, even when given as a grant, must be a good value. In preparing a budget and then in spending the public's money, one must give some thought to usefulness. For instance, how does one know the market price for a case manager? How to determine whether the cost of a van is ordinary and necessary? SNAPS grantees should conduct a cost-benefit analysis to determine whether the 'benefit" is worth the expenditure (cost). For instance, how many clients can a full- time case manager serve? When does an agency need a van? SNAPS grantees will need to be familiar with the marketplace and do necessary comparisons to make such determinations.

Cost Allowability

In general, allowable costs must be necessary and reasonable, allocable to the program, authorized or not prohibited, conform to and be consistent with rules and requirements,

and not charged to any other program. Under "authorized or not prohibited," SNAPS grantees should not try to be too creative, but rather to follow the activities that are identified as eligible under the funding program

Cost Allocability

A cost is allocable to a HUD program if it is treated consistently with other similar costs, incurred specifically for the program, benefits program or can be distributed based on a reasonable proportion, and is necessary to operations.

While OMB establishes standards for when costs are allowable and allocable, one should realize that the program's regulations and desk guide will likely be more restrictive. Just because OMB says that an activity might be allowable, the SNAPS program specifically might say the activity is either not allowable or allocable.

Apply Fund Accounting to New or Expanded Projects

The McKinney Act authorizes HUD to award funds to new projects or to fund the expansion of existing projects. When HUD awards funds for a SNAPS expansion project, the grantee's fund accounting system must be sufficient to identify costs applied to the existing project versus the newly funded portion.

Some examples of SNAPS expansion projects include:

Second floor is built onto an existing transitional housing project

- Rooms not previously used for the homeless are converted to bedrooms
- Additional substance counselor is hired to serve the needs of new clients

Only the pro-rated share of these related costs are eligible for SNAPS assistance. ***Pro-Rating Costs When HUD Is Only One Funding Source*** Pro-rating costs is required by HUD where the full cost of the activity is not the actual cost for HUD's portion. For instance, a building has rooms for 20 clients, of which eight are HUD- funded. In this instance, HUD will only pay for eight of the units since they are the only ones for which it receives a benefit.

To substantiate HUD's pro-rata share, the SNAPS grantee must always have source documentation.

The type of cost determines the method for pro-rating costs. Depending on

The cost to be pro-rated, a SNAPS grantee will use one of the two following methods: · **Personnel** costs (salaries) for supportive services, operations and administration staff are pro-rated based on actual-not budgeted-time. Personnel costs should include benefits and be documented with time and activity records.

· **Non-personnel** costs (such as buildings and equipment) are pro-rated based on an established base, such as square footage of space, amount of time used or actual mileage, and documented with logs, plans, etc.

SNAPS grantees must remember that budget assumptions can be based on percentages but actual expenditures govern costs, even when pro-rated.

Drawing Down Funds Properly

SNAPS Grantees must follow the proper procedures in order to draw down funds through HUD's Line of Credit Control System Outlined below is a list of questions SNAPS Grantees should ask to ensure properly drawing funds through LOCCS. This is also included as a checklist in the appendix of this manual.

Is caller an authorized user of LOCCS?

Has grant agreement been executed by HUD? Has grant been issued a voice response number? Have costs been recorded in general ledger?

Have costs been adjusted for existing versus expansion costs? Are amounts supported by source documentation?

Has adequate project progress been made to warrant release of funds? Are costs being charged to the correct grant?

Has program income (such as, resident rents) been applied toward project costs prior to drawing from the U.S. Treasury?

· Is request consistent with approved application, technical submission or amendment budget line item (BLI)?

· Is request consistent with approved application, technical submission or amendment exhibits?

Is request for correct grant term?

- Is request for correct month?
- Noting that minimum match must be demonstrated annually, what is source and use of match for this draw?

Will special authorization be required to release a post 90-day draw?

- Will the annual progress report (APR) need to be revised?
- Has voucher form HUD 27054 been filled out prior to making phone call; signed and dated upon call-in?

· Has an operating start date in LOCCS been established for first drawdown of funds for leasing, supportive services or operating costs?

- Because fund accounting affects an agency's budgets and the way it operates it programs, it also necessarily has an impact on the way an agency meets its match obligations, which will be discussed in the next chapter.

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