INTERNATIONAL FEDERATION OF ACCOUNTANTS

545 Fifth Avenue, 14th Floor
New York, New York 10017
Internet: http://www.ifac.org
Tel: (212) 286-9344
Fax: (212) 286-9570

DATE:	21 OCTOBER 2005
MEMO TO:	MEMBERS OF THE IPSASB
FROM:	PAUL SUTCLIFFE
SUBJECT:	USA OCCASIONAL PAPER

ACTION REQUIRED

The IPSASB is asked to:

- **Review** the draft USA Paper and approve it for issue, or provide directions for further development.

AGENDA MATERIAL:

		Pages
16.2	USA Discussion Paper	16.2– 16.58

BACKGROUND

The Draft USA Paper has been prepared by David Bean (USA Technical Advisor) and GASB staff with input from the USA Member, GASB Chair and staff of FASAB.

A first draft Paper was included in Agenda materials for the IPSASB meeting in July 2005. At that meeting, it was noted that the paper had been prepared to reflect matters discussed at the March 2005 meeting in Oslo. Members agreed to provide comments to the authors out of session. Comments were received from Australia, Canada, the OECD Observer and staff. The authors have further developed the Paper to respond to those matters.

Members are requested to review the Paper with a view to its approval for issue, subject to amendments identified in the course of discussion at the forthcoming meeting.

INSERT COVER

THE ROAD TO ACCRUAL ACCOUNTING IN THE UNITED STATES OF AMERICA

This Occasional Paper was approved for publication by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants. It was published in XXX 20XX.

The International Federation of Accountants (IFAC) is the global organization for the accountancy profession. It works with its 158 member organizations in 118 countries to protect the public interest by encouraging high quality practices by the world's accountants. IFAC members represent 2.5 million accountants employed in public practice, industry and commerce, government and academe. Its structure and governance provide for the representation of its diverse constituencies and interaction with external groups that rely on or influence the work of accountants.

The mission of the International Federation of Accountants is to serve the public interest and contribute to the strengthening of the international economy by developing the global accountancy profession, establishing high quality standards and promoting international convergence of standards.

Information about the IPSASB can be found at http://www.ipsasb.org

The approved text of this Occasional Paper is that published in the English language. Copies of this paper may be downloaded free of charge from the IFAC internet site.

International Federation of Accountants

545 Fifth Avenue, 14th Floor

New York, New York 10017-36100 USA

Fax : +1 212-286-9570

edcomments@ifac.org

THIS PAGE TO BE UPDATED

ISBN: 1XXXX

ACKNOWLEDGEMENT

The International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) is indebted to David R. Bean, Dean Michael Mead, Kenneth R. Schermann, and Roberta E. Reese of the Government Accounting Standards Board (GASB) for preparing this occasional paper.

The IPSASB would also like to thank staff at the Financial Accounting Standards Advisory Board (FASAB) for their input to this paper.

The views expressed are those of the authors and not necessarily of the IPSASB or IFAC.

The paper refers to a number of publications GASB and FASAB. These publications can be accessed at www.gasb.org and www.fasab.org

David Bean is Director of Research and Technical Activities at the GASB and the Technical Advisor to the USA representative on the IPSASB.

Dean Michael Mead is Project Manager at GASB.

Kenneth R Schermann is Senior Technical Advisor at GASB.

Roberta E Reese is Project Manager at GASB.

PREFACE

An increasing number of jurisdictions are moving to adopt the accrual basis of accounting for financial reporting by public sector entities. Some jurisdictions have already adopted the accrual basis, others are in the process of migrated from the cash basis to the accrual basis and some continue to strengthen reporting under the cash basis or near cash basis as preparation for the migration at an appropriate time in the future.

Adoption of the accrual basis of accounting will enhance the accountability and transparency of the financial statements of governments and government agencies and provide better information for planning, and management purposes.

The challenges for those moving to the accrual basis include both development and implementation issues. They also include establishment of appropriate institutional arrangements and mechanisms to promote, manage and assist in the movement to the accrual basis. Different environments and administrative structures will evoke different responses to these issues.

This paper considers the experiences of the United States of America in its movement to accrual accounting. It outlines the development of administrative arrangements for standards setting over 70 years at the Local, State and Federal Government levels in the USA, and highlights key factors shaping the standards setting structure. It also provides a detailed overview of the conversion to accrual accounting by state and local governments, the standards issued by GASB to lead and support that conversion and identifies key milestones in the conversion process.

Draft for IPSASB Review November/December 2005 Cape Town

THE ROAD TO ACCRUAL ACCOUNTING IN THE UNITED STATES OF AMERICA

CONTENTS

IPSASB OCCASIONAL PAPER

The Road to Accrual Accounting in the United States of America

By David R. Bean, Dean Michael Mead, Kenneth R. Schermann, and Roberta E. Reese

CHAPTER 1—THE ENVIRONMENT

Governments in the United States

To gain a true appreciation for the 70-year road to accrual accounting for governments in the United States of America (U.S., or United States), it is helpful to understand U.S. governmental structure. All governments in the United States can trace their roots to the state governments. Whether it was the creation of the U.S. government (federal government) in 1776 by the 13 original colonies (which became states) or the sanctioning of the 87,576 units of state and local government[1] that have been created as a result of state statutes, the sovereignty of the states has influenced not only the structure of governments, but also their accounting standards. The role of all forms of government in establishing accounting standards and the movement to accrual accounting are the focus of this paper.

Exhibit A, on the following page, provides some interesting statistics on how the 87,576 units of government in the United States are structured.

[1]U.S. Department of Commerce, Bureau of the Census, *2002 Census of Governments.*

Exhibit A

United States
Units of Government
2002 Census

Type of Government	Number
Federal	1
State	50
Local Governments:	
General Purpose:	
County	3,034
Municipal	19,429
Township	16,504
Special-Purpose:	
School districts	13,506
Fire protection	5,725
Water supply	3,405
Housing and community development	3,399
Drainage and flood control	3,247
Soil and water conservation	2,506
Sewerage	2,004
Cemeteries	1,666
Libraries	1,580
Parks and recreation	1,287
Sewerage and water supply districts	1,446
Other multiple-function districts	1,729
Other special districts	7,058
Total	87,576

Environmental Differences between the Public and Private Sectors in the United States

The purpose for which governments were formed in the United States is different from the purpose for which business enterprises are created. At its core, government’s role is to maintain or improve the well-being of citizens by providing public services and goods, such as public safety, public education, and public transportation, which the free market system often does not provide adequately or equitably. Additionally, governments have the ability to create and enforce laws that provide structure and order for the functioning of society, including providing the foundation for the conduct of free-market business enterprise. At their core, business enterprises in the private sector are formed to generate a return on investment and enhance the wealth of their owners.

One contrast of the financial relationship between U.S. citizens and their government and between shareholders and their business enterprise is the involuntary aspects of the former and voluntary nature of the latter. While U.S. governments are representational democracies, because individual citizens involuntarily provide resources in the form of taxes, they are entitled to hold governments to a high degree of accountability, which encompasses not only a demonstration that resources obtained were used in a manner consistent with the purpose for which they were obtained, but also an assessment of whether the resources raised in the current period were sufficient to fund the cost of the services provided, or whether the funding of current-year costs was shifted to future periods.

Taxation—the most significant involuntary resource for most governments in the United States—is a source of revenue that is not found in the private sector. The conceptual difference between tax revenue and sales revenue, the predominant source of business enterprise revenue, is that taxes revenues are not directly correlated to the services provided to the individual taxpayers, whereas sales represent an exchange of a product or service for cash or another asset of similar value. The governments' ability to tax its citizens leads to the conclusion that governments effectively have permanent existence and are not subject to directly observable market forces that affect business enterprises' continued existence.

In addition, governments acquire most capital assets because of the asset's capacity to provide services to the citizenry, whereas business enterprises acquire capital assets with the objective of using them to generate future cash flows. This key difference, along with social policy obligations has had a profound affect on both U.S. and international accounting standards.

Finally, a government's budget takes on a special significance. In the United States, many consider the budget to be the most important financial document that governments issue. For business enterprises, the budget represents an internal financial management plan. For government, the budget is an expression of public policy priorities and, in most cases, serves to legally authorize the purposes for which public funds can be spent. Furthermore, in the U.S. form of representational democracy, citizens and their elected representatives have the ability to hold their governments accountable for complying with the requirements of the budget.

All of these environmental differences have had a profound effect not only on how standards are set in the United States, but also on the accounting principles established by U.S. standards setters.

Governmental Accounting Standards Setting in the United States—A Brief History

State and Local Government Standards Setting

Formal accounting standards setting for state and local governments in the United States began in 1934 with the establishment of the National Committee on Municipal Accounting (NCMA). The NCMA issued its first bulletin (standard) in the year it was created. In 1949 the NCMA became the National Committee on Governmental Accounting (NCGA), in part to recognize in name the important role that state governments play in regulating local governments. As noted earlier, this role is one of the important environmental differences that set the United States apart from many governments around the world. Instead of accounting principles being established or at least approved at the federal (national) government level, the power to set accounting standards for state and local governments resides with the 50 individual states. Recognition of what 50 separate sets of accounting standards could have on the municipal financial market (over 30,000 of the over 87,000 local governments have at least one public debt issue outstanding that totals over $1.5 trillion)[2] was one of the primary motivators in establishing a recognized standards setter. The number of potential standards setters increases greatly when Native American tribes (which are sovereign entities but choose to follow state and local government accounting standards) are taken into account.

After the initial standards were developed, the Committee met on an ad hoc basis to keep the standards current. Combined, the NCMA and NCGA issued 17 bulletins and a final authoritative update and codification of those standards in the form of the *Governmental Accounting, Auditing, and Financial Reporting* (*GAAFR*, or the blue book). The blue book remains an important nonauthoritative source for government finance officers, with the latest edition being released in 2005. The *GAAFR* is now published by the Government Finance Officers Association of the United States and Canada (GFOA).

[2]Department of Commerce, Bureau of the Census, 2004.

In 1973, the National Council on Governmental Accounting (Council) was formed to reexamine the financial reporting model. By establishing a regular meeting schedule, the 21-member Council moved state and local government accounting standards setting from an ad hoc basis to a structured basis to address important issues of the day. During its 11 years of existence, the Council issued seven statements, 11 interpretations, and one concepts statement. For 51 years, through the lifetime of the NCMA, NCGA, and the Council, the GFOA played an important role in public-sector standards by providing a corporate umbrella to the state and local government standards-setting process.

The creation of the current standards setter for state and local governments, the Governmental Accounting Standards Board, can be traced back in part to one standard and one Concepts Statement issued by its sister organization, the Financial Accounting Standards Board (FASB). The FASB stated in its Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, issued in 1980, that the provisions apply to ". . . an ongoing plan that provides pension benefits for the employees of one or more employers, including state and local governments. . . ." That standard was followed later that year by FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*, which noted, "the Board is aware of no persuasive evidence that the objectives in this Statement are inappropriate for general purpose external financial reports of governmental units." Many around the world agree with and adhere to this principle; however, there were those in the United States who believed that there *was* persuasive evidence that both the pension standard and the objectives were inappropriate for the public sector, and they set out to establish an independent standards-setting body for state and local governments.

After several years of negotiations, including reaching an arrangement on jurisdiction, the GASB was formed in 1984. Like its sister organization the FASB, the GASB also was established under the auspices of the Financial Accounting Foundation (FAF). The FAF relationship is the same with the FASB and the GASB. The FAF Trustees appoint GASB members, raise moneys for the support of the GASB, and provide oversight for the GASB. With the establishment of the GASB, the FAF Trustee membership was expanded in 1984 by three to 16 members to accommodate members with state and local government backgrounds.

The GASB started with a five-member Board that consisted of a full-time chairman and four part-time members. Over the years, the Board has seen several structure changes, with the latest occurring in 1997. At that time, the Board was expanded to seven members, with the chairman continuing to serve as the only full-time member. The six part-time members devote approximately one-third of their time to GASB activities. All of the Board members are compensated for their services. The Board members are appointed based in part on their backgrounds; however, as independent individuals they are not representatives of any government or organization.

The Board is supported by 18 technical and direct administrative staff (as of December 31, 2005). The GASB is also supported by the Governmental Accounting Standards Advisory Council (GASAC). The GASAC is a 29-member body that provides advice and counsel to the GASB on issues ranging from the Board's technical agenda to constituent communications. To date, the GASB has issued 47 standards, six Interpretations, 12 Technical Bulletins, and three Concepts Statements.

The FAF provides administrative support for both the FASB and the GASB, including publication production, accounting, and human resources. The Foundation as a whole, including the FASB and the GASB, has a total complement of over 150 employees.

Federal Government Standards Setting

On the federal government side of the ledger, the responsibility for financial reporting resided with the General Accounting Office (GAO, now the Government Accountability Office), the United States Treasury, and the Office of Management and Budget. Over the years, all three entities issued guidance that addressed financial reporting issues. Most of this guidance was consistent, although there were cases of conflict.

In 1990, the current U.S. national government standards setter, the Federal Accounting Standards Advisory Board (FASAB), was formed. It was established based on a memorandum of understanding between the FASAB's three sponsors—the Comptroller General of the United States (representing the GAO), the Secretary of the U.S. Treasury (Treasury), and the Director of the Office of Management and Budget (OMB). The FASAB was created concurrent with the passage of the Chief Financial Officers Act, which, as amended, requires the federal government (including its component units) to issue annual, audited financial statements.

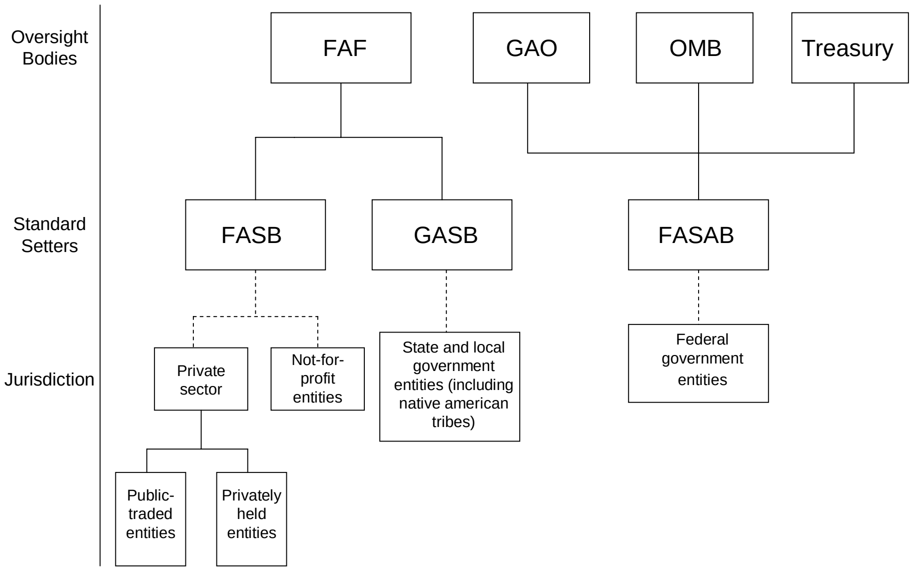
The FASAB parallels the FASB and the GASB in many respects. One key difference is that because FASAB involves both the executive and legislative branches of the federal government, as well as the private sector, in jointly developing accounting standards, compliance with the U.S. Constitution requires that an administratively established FASAB have the legal status of an advisory board. Because the FASAB's authority stems from those of the sponsors that established it, FASAB submits any concepts and standards it develops to its sponsors for review. The concept or standard is then issued unless OMB or GAO objects within 90 days. To date, all concepts and standards developed by FASAB have been issued.

The entire 10-member FASAB serves on a part-time basis and is funded by appropriations from the three sponsors and the Congressional Budget Office. To enhance the FASAB's independence, a majority of members are not federal government employees. The FASAB is supported by an eight-member technical staff (as of December 31, 2005), supplemented by contractors from time to time.

During its existence, two former GASB members have served on the FASAB and one former FASB member currently serves on the FASAB and one former FASB member recently retired as a FASAB member. To date, the FASAB has issued 30 Statements, six Interpretations, and four Concepts Statements.

As the chart in Exhibit B on the following page illustrates, each of the standards setters has defined jurisdictional lines of authority, and all three are now recognized by the American Institute of Certified Public Accountants (AICPA)—which sets generally accepted auditing standards for all entities in the United States, with the exception of Securities and Exchange Commission–registered public companies—as bodies that establish generally accepted accounting principles in the United States. Within the federal domain, a small number of entities, such as the U.S. Postal Service and the Tennessee Valley Authority, follow standards established by the FASB.

Standard Setting Structure in the U.S. Exhibit B



Even though there are references made throughout this paper to the FASAB, the primary focus is on the conversion to accrual accounting by state and local governments based on the standards issued by the GASB. Appendix A provides an overview of the federal reporting model.

CHAPTER TWO—THE ROAD TO ACCRUAL-BASIS STANDARDS

When the last chairman of the National Council on Governmental Accounting formally transferred the responsibilities of state and local government standards setting by turning the gavel over to the first chairman of the GASB in June 1984, the transfer included a list of suggestions for projects that the NCGA had yet to complete. Two of the projects, the measurement focus and basis of accounting (MFBA) project and the financial reporting model project, became the basis for what eventually would become the new accrual-based financial reporting model for state and local governments in the United States. When the GASB was established, some predicted that the MFBA and reporting model projects would take no more than two years to complete. In the end, however, it was a 15-year endeavor.

For over 70 years, financial reporting for state and local governments in the United States was based primarily on a current financial resources measurement focus and modified accrual basis of accounting (often referred as the modified cash basis in other parts of the world), within a fund accounting model. Under the modified accrual basis of accounting, revenues are recognized when they are available to liquidate current liabilities (normally defined by an availability period) and expenditures are recognized when they are normally liquidated with expendable available financial resources (normal is defined in terms of what occurs for most governments, so that a government cannot delay the recognition of a normal operating expenditure just because it does not have resources available as of the balance sheet date). This MFBA/fund accounting model provides an important link between budgeting and external financial reporting. Most U.S. government budgets are adopted using the cash basis of accounting, the modified accrual basis of accounting, or a budgetary basis that is somewhere between the two.

The financial position of the government was reported in a balance sheet that presented all financial resource assets and current financial resource liabilities in the funds, with separate account groups that presented capital assets and long-term liabilities. The GASB recognized that more complete reporting was necessary to meet the objectives set forth in GASB Concepts Statement No. 1, *Objectives of Financial Reporting*. Those objectives are identified in Chapter 5 of this paper.

Many Starts and Stops along the Way

The reexamination of the state and local governmental financial reporting model was added to the GASB's original technical agenda in 1984. This section of the paper is intended to show some of the difficulties that were faced, at least from the state and local government perspective, in moving to a new accrual-based financial reporting model. It was a 15-year endeavor that hopefully other nations in their transition to accrual accounting will not encounter. Despite the downsides associated with the length of the project, the long process ultimately did lead to greater acceptance of the final standards. Everyone had "his day in court." In other words, throughout this journey—due process documents, public hearings, focus group meetings, task force meetings, and a variety of other venues—all of the GASB's constituents had an opportunity for their views to be heard by the GASB.

The project began with a user needs study that resulted in the publication of the GASB Research Report, *The Needs of Users of Governmental Financial Reports*, by David B. Jones and others in 1985. This effort was followed by Concepts Statement 1. Before turning its attention to the financial reporting model, the GASB tackled the financial reporting entity issue with the issuance in 1990 of GASB Statement No. 14, *The Financial Reporting Entity*.

As work was being done on the financial reporting model, the GASB also was advancing a separate project on MFBA issues. This project began with a discussion memorandum (DM) in 1985, *Measurement Focus and Basis of Accounting—Governmental Funds*. A discussion memorandum is a neutral staff document that was used in this case to solicit views on alternatives for fund reporting, ranging from the current financial resources measurement focus and modified accrual basis of accounting (the model that was in place at the time for governmental funds) to the economic resources measurement focus and accrual basis of accounting (the model in place at the time of proprietary funds—business-type activities). With feedback received on the DM, the GASB embarked on developing an exposure draft (ED). An ED, as used by the GASB, is a proposed Statement of the Board. Although the proposed provisions of an ED are subject to change based on due process feedback, it is not intended to be used as a "trial balloon." The first ED on this project, issued in 1987, proposed a total financial resources measurement focus and accrual basis of accounting MFBA for the governmental funds. (Business-type activities were being addressed in another project at that time.) However, the proposed model was not well received by the GASB's constituency. A second exposure draft was issued in 1989. That ED continued forward with the proposal of a total financial resources measurement focus and accrual basis of accounting, but eliminated some of the more controversial issues by limiting the scope of application to just the governmental fund operating statements. This effort resulted in the issuance in June 1990 of GASB Statement No. 11, *Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements*. Statement 11 was unique in the fact that due to its scope, which focused only on the operating statement, its effective date was dependent on the issuance of future guidance that would deal with the balance sheet issues that were deferred in the more narrowly scoped MFBA project.

After the issuance of Statement 11, the GASB turned its attention to a variety of financial reporting model issues, including how to display the long-term assets and liabilities arising from the use of an accrual basis of accounting in the governmental funds and what effect, if any, those assets and liabilities should have on fund balances. However, because of the contentiousness of the issues involved, the financial reporting model project did not progress as expected. As a result, the GASB concluded that it could complete a narrow-scope project that would address the balance sheet display issues deferred from GASB Statement 11 and certain operating statement issues in time to implement GASB Statement 11 by its intended effective date of periods beginning after June 15, 1994.

In 1992, the GASB issued a preliminary views document (PV), *Implementation of GASB Statement No. 11, "Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements*," on the narrow-scope project issues. A PV is a Board document that is intended to solicit views from constituents on GASB consensus positions when it is believed that responses will be sharply divided on the issues or the GASB itself is sharply divided on the issues. That PV included both a preliminary (majority) and an alternative view that presented models for addressing the Statement 11 balance sheet display issues. However, the majority of respondents preferred that the effective date of Statement 11 be deferred until the financial reporting model project was completed, or at least until substantial progress was made in determining the direction that would be taken in completing that project. After considering the due process input, the GASB concluded in 1993 that the effective date of Statement 11 should be deferred until approximately two years after an implementation standard containing balance sheet guidance was issued. This deferral guidance was contained in GASB Statement No. 17, *Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements: Amendment of the Effective Dates of GASB Statement No. 11 and Related Statements.* At the time, some considered this action to be a major setback in the march to accrual accounting. However, that proved not to be the case.

After the issuance of Statement 17, the GASB again directed its efforts to some of the major issues in the reporting model project. As part of this broad-scope approach, the GASB considered the possibility of applying accrual accounting at different levels of the financial reporting pyramid, reviewed a variety of aggregated reporting approaches, and discussed the relationship between the financial reporting objectives in Concepts Statement 1 and an aggregated reporting approach. The GASB also held several meetings throughout this stage of the process with a project task force comprising individuals from state and local governments, the financial statement user community, public accounting, and academia. Based on the information obtained through these extensive efforts, the GASB ultimately agreed to develop alternative models to expose through an invitation to comment (ITC), *Governmental Financial Reporting Model*, released in 1994. An ITC, as used by the GASB, is a staff document that may contain elements of both a DM and a PV.

The ITC presented two alternative models that differed in many ways, but also included common features that represented modifications to the then-current model. Both models included a requirement for an additional level of aggregated financial statements. Both also included a requirement to display financial statement data for major individual funds. Enhancements to the budget-to-actual results comparison and changes in the reporting for fiduciary funds also were key features of the models in the ITC. Despite these similarities, the models were significantly different in many areas, including levels of aggregation, the measurement focus and basis of accounting used at the different levels of reporting, and the methods used for reporting capital outlay, assets, and debt for governmental activities.

The GASB received over 150 responses to the ITC, held four public hearings, and conducted eight user focus group sessions. There was support for both models presented in the ITC. Many respondents favored some aspects of each model. Based on the analysis of the constituents' reactions to the issues raised in the ITC, the GASB developed the basic financial statement requirements that formed the basis of the next due process document that was issued in 1995—a PV, *Governmental Financial Reporting Model: Core Financial Statements*.

The PV represented a further broadening of the project with the consideration of certain issues included in other GASB projects. In addition to the financial reporting model issues included in the ITC, the proposals addressed in the PV also incorporated issues developed in four Discussion Memorandums:

- *Accounting and Financial Reporting for Capital Assets of Governmental Entities*, issued in 1987
- *Measurement Focus of Governmental Business-type Activities or Entities*, issued in 1988
- *Capital Reporting*, issued in 1989
- *Reporting Contributions, Subsidies, Tap Fees, and Similar Inflows to Enterprise and Internal Service Funds and to Entities Using Proprietary Fund Accounting*, issued in 1993.

The PV model proposed that to best meet the different needs of diverse user groups, basic financial statements for governments should include both fund financial statements and aggregated financial statements. The fund financial statements would preserve the nature of fund accounting and, to a large extent, the display characteristics of the then-current model. The aggregated financial statements were intended to satisfy users' needs for aggregated information about the government as a whole to help assess the longer-term effects of current-period transactions and events associated with governmental activities.

The GASB received 230 responses to the PV, held six public hearings, and conducted 17 user focus groups to gather constituent opinions about the various provisions of the PV. In addition, 20 state and local governments participated in a field test of the PV model. The GASB's consideration of the input from all of those sources helped form the basis for the financial reporting model set forth in an ED, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, issued in January 1997. Much of the PV proposal, including the overall approach, was carried over to the ED.

The GASB received 400 formal responses to the ED and an additional 1,100 form letters that were the result of a letter-writing campaign. The GASB also held five public hearings and conducted two meetings with an expanded task force and, on several occasions, met with the

GASAC and representatives from major constituent groups to discuss various aspects of the ED. After an additional two years of deliberations, GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* was issued in June 1999. After a challenging 15 years, this important leg of the journey was completed.

The Major Features of GASB Statement 34

The annual financial reports of U.S. state and local governments[3] prepared based on the provisions of GASB Statement 34 contain three parts:

1. Management's discussion and analysis—a specific form of required supplementary information that appears at the front of the financial report
2. Basic financial statements—aggregated (government-wide) and fund financial statements, including note disclosures
3. Required supplementary information—additional presentations generally in the form of schedules that follow the basic financial statements.

This portion of the paper considers the notable aspects of each of these three major parts of the new financial reporting model.

Basic Financial Statements

The centerpiece of Statement 34 was the revision and expansion of the general purpose (or basic) financial statements. Statement 34 added two new accrual-based statements for the government as a whole to the basic financial statements, improved the existing fund-based financial statements, and added several new disclosures to the financial statement notes. These disclosures were later supplemented by additional standards that reviewed the entire body of required note disclosures—Statement No. 38, *Certain Financial Statement Note Disclosures,* and Statement No. 40, *Deposit and Investment Risk Disclosures.*

[3]The GASB does not directly establish standards for individual department reports; however, state and local government departments that do issue "GAAP" reports follow GASB standards.

Government-wide Financial Statements

Perhaps the most significant change introduced by Statement 34 is the requirement that governments for the first time prepare financial statements that provide comprehensive information for the entirety of a government's operations. The *statement of net assets* and *statement of activities,* as they are called, are prepared using the accrual basis of accounting and the economic resources measurement focus. These statements separately display the information for a government's "governmental activities" and "business-type activities," as well as its "component units." The government-wide statements do not report information regarding a government's fiduciary activities, such as public employee pensions or trusts. The GASB believes that this information should be reported distinctly in separate *fiduciary fund statements* because the resources related to fiduciary activities belong to others and are not available to support the government's programs. Including these resources in the government-wide statements might mislead a user about the financial position and condition of a government. However, the GASB also believed that because of the high level of accountability associated with these resources in the United States, the presentation of fiduciary fund statements should remain in the basic financial statements.

Although Statement 34 introduced the government-wide statements to the U.S. state and local government financial reporting model, these statements are by no means the first use of accrual accounting by those governments. As noted earlier, accrual supplanted the cash basis since the beginning of formal standards setting by state and local governments in the 1930s. The "proprietary funds" and certain fiduciary funds have reported using accrual accounting and, as noted in Chapter 1, the governmental funds and other fiduciary funds used a modified accrual basis of accounting.

Statement of net assets. A significant feature of the statement of net assets is the presentation of capital assets at historical cost less accumulated depreciation and the inclusion of long-term debts. (See Exhibit C on the next page.) As noted previously, capital assets and long-term liabilities were reported in "account groups" in the fund-based statements. In some cases, this was the first time that many governments reported infrastructure assets such as roads, bridges, and street lighting systems. (Reporting infrastructure assets previously had been optional.)

Exhibit C

Common County
Statement of Net Assets
June 30, 2002

	Governmental Activities	Business-type Activities	Total
ASSETS			
Pooled cash and investments (Note 2)	$ 54,795,200	$ 31,003,016	$ 85,798,216
Investments, plus accrued interest (Note 2)	7,455,708	—	7,455,708
Accounts receivable, net	1,891,555	1,301,656	3,193,211
Taxes receivable, net	2,000,000	—	2,000,000
Notes receivable, net	1,296,745	875,399	2,172,144
Health plan contributions receivable, net	14,733,173	—	14,733,173
Due from other governments	27,464,800	—	27,464,800
Inventories and prepaid expenses	1,022,119	—	1,022,119
Restricted assets—noncurrent (Note 2)	9,599,316	26,596,649	36,195,965
Pension assets (Note 7)	40,259,000	—	40,259,000
Capital assets (Note 3):			
Land and construction in progress	63,009,780	4,257,884	67,267,664
Infrastructure, net	584,810,374	—	584,810,374
Building and improvements, net	75,414,530	10,671,153	86,085,683
Equipment and vehicles, net	25,629,727	2,630,700	28,260,427
Total capital assets	748,864,411	17,559,737	766,424,148
Total assets	909,382,027	77,336,457	986,718,484
LIABILITIES			
Accounts payable	21,782,319	476,170	22,258,489
Internal balances	393,496	(393,496)	—
Due to other governments	3,715,414	—	3,715,414
Salaries and benefits payable	3,242,681	251,268	3,493,949
Deferred revenue	13,820,551	—	13,820,551
Accrued interest	1,065,950	—	1,065,950
Long-term liabilities (Notes 6 and 8):			
Portion due or payable within one year:			
Claims payable	2,650,000	—	2,650,000
Certificates of participation (COPs) payable	3,050,000	14,000	3,064,000
Bonds and notes payable	8,220,000	600	8,220,600
Capital leases	3,000,000	—	3,000,000
Compensated absences	856,000	—	856,000
Portion due or payable after one year:			
Claims payable	2,450,000	—	2,450,000
COPs payable	84,068,143	1,700,180	85,768,323
Bonds and notes payable	46,326,918	64,206	46,391,124
Capital leases	8,400,882	—	8,400,882
Compensated absences	9,427,121	—	9,427,121
Accrued landfill closure/postclosure care costs (Note 9)		26,596,649	26,596,649
Total liabilities	212,469,475	28,709,577	241,179,052
NET ASSETS			
Invested in capital assets, net of related debt	649,403,468	15,780,751	665,184,219
Restricted for:			
Capital projects	5,664,726	—	5,664,726
Debt service	10,961,357	—	10,961,357
Road projects	4,386,138	—	4,386,138
Redevelopment	2,160,075	—	2,160,075
Other purposes	2,212,297	—	2,212,297
Unrestricted	22,124,491	32,846,129	54,970,620
Total net assets	$ 696,912,552	$ 48,626,880	$ 745,539,432

Capital assets are valued initially on the statement of net assets at their historical cost, which contrasts with the practice of reporting them by their replacement cost or fair value, as some countries that employ accrual accounting do. (The GASB does require fair value measurements for the reporting of certain financial instruments, such as investments.) The GASB's choice of historical cost over fair value is a reflection of a general emphasis on reporting the cost of operations versus the reporting of financial position—that is, what *did* it cost to provide the service versus what *will* it cost to provide the service at today's price.

Net assets in this statement are divided into three categories. The portion of net assets invested in capital assets is shown separately. The remaining net assets are then divided between those that are restricted to specific purposes and those that are unrestricted. Net assets are considered restricted when constraints are imposed by external parties or through constitutional provisions or enabling legislation. The restricted net assets are further divided by major category of restriction, which is discussed later in this paper.

Statement of activities. The second government-wide statement differs from the more traditional statement of revenues and expense. The statement of activities is designed to provide useful information about the cost of public services and how they are financed. (See Exhibit D on the next page.) The upper half of the statement, which flows from left to right, presents expenses, then program revenues, then net (expense) revenue, and then continues downward by presenting general revenues and other changes in net assets, leading to total change in net assets.

Exhibit D

Common County
Statement of Activities
For the Year Ended June 30, 2002

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
Activities:	**Expenses**	**Fees, Fines, and Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Governmental Activities**	**Business-Type Activities**	**Total**
Governmental:							
General government	$ 17,570,842	$ 15,030,242	$ 518,456	$ 525,530	$ (1,496,614)		$ (1,496,614)
Public protection:					0		$ 0
District attorney	20,255,385	489,119	13,732,422	—	(6,033,844)		(6,033,844)
Probation	14,506,407	1,299,113	4,487,771	—	(8,719,523)		(8,719,523)
Sheriff and coroner	42,040,101	4,149,675	2,764,342	400,000	(34,726,084)		(34,726,084)
Trial court	8,591,642	6,013,147	346,525	—	(2,231,970)		(2,231,970)
Fire protection	9,450,618	289,105	—	200,822	(8,960,691)		(8,960,691)
Other	16,417,447	1,135,267	3,523,072	—	(11,759,108)		(11,759,108)
Public ways and facilities	44,917,710	6,057,919	3,385,940	5,868,992	(29,604,859)		(29,604,859)
Health and sanitation	61,521,861	7,669,727	40,340,851	—	(13,511,283)		(13,511,283)
Public assistance	171,370,511	16,386,459	134,869,880	815,500	(19,298,672)		(19,298,672)
Education	2,815,571	152,649	465,720	—	(2,197,202)		(2,197,202)
Culture and recreation	1,552,175	251,975	119,686	—	(1,180,514)		(1,180,514)
Interest and fiscal charge	9,727,637	—	—	—	(9,727,637)		(9,727,637)
Total governmental ac	420,737,907	# 58,924,397	204,554,665	7,810,844	(149,448,001)		(149,448,001)
Business-type:							
Solid waste	8,494,969	10,510,247	—	—		$ 2,015,278	2,015,278
Other programs	1,564,125	521,664	—	18,853		(1,023,608)	(1,023,608)
Total business-type a	10,059,094	# 11,031,911	—	18,853		991,670	991,670
Total Common County	$ 430,797,001	$ 69,956,308	$ 204,554,665	$ 7,829,697	(149,448,001)	991,670	(148,456,331)
General revenues:							
Taxes:							
Property taxes, levied for general purposes					31,598,045	—	31,598,045
Property taxes, levied for fire protection					4,708,422	—	4,708,422
Property taxes, levied for library					1,748,309	—	1,748,309
Tax increments for redevelopment districts					1,164,935	—	1,164,935
Sales taxes					23,992,788	697,962	24,690,750
Grants and contributions not restricted to specific programs					30,431,877	—	30,431,877
Earnings on investments					5,687,047	2,765,944	8,452,991
Miscellaneous					18,517,899	—	18,517,899
Transfers					106,000	(106,000)	—
Total general revenues and transfers					117,955,322	3,357,906	121,313,228
Change in net assets					(31,492,679)	4,349,576	(27,143,103)
Net assets—beginning					728,405,231	44,277,304	772,682,535
Net assets—ending					$ 696,912,552	$ 48,626,880	$745,539,432

47

The left-hand column of the statement presents expenses by functional or program category. A functional classification is the minimum requirement of Statement 34, but governments are encouraged to provide more detailed program- and service-level information if such information is determined to be essential to the users of their financial statements. If a government wishes to allocate indirect expenses, such as general government, to the direct expense categories, it is required to include an additional column, to the right of the expenses column, that displays the allocation amounts.

The program revenues are presented in columns to the right of the expenses. Program revenues are those generated by the activities themselves, such as greens fees at a municipal golf course, license fees, and fines, as well as grants and contributions that are restricted to specific programs. The latter group is divided between those for operating purposes and those for capital purposes.

Subtracting expenses from program revenues produces the "net (expense) revenue" amounts in the right-hand columns. These amounts represent the "net cost" to the public: the portion of program costs that is not "self-financed," but rather requires financing from general revenues—principally taxes—and other sources. In this sense, program revenues are those that reduce the net cost of programs requiring general revenue support. The lower portion of the statement describes how the net cost of programs was financed. All taxes are included in general revenues, even those that are dedicated to specific purposes. Although a government may restrict dedicated taxes to financing a particular program or function, such taxes do not derive from the activities of the program or function, as do user charges. The statement concludes with the overall change in net assets.

Another new feature introduced by Statement 34 is the separation of "special and extraordinary items" from other revenues and expenses in both this statement and the other income statement analogues. Extraordinary items are transactions or other events that are both unusual in nature and infrequent in occurrence.[4]

A special item is a transaction or other event that is within the control of management and is *either* unusual in nature *or* infrequent in occurrence. An example might be a government selling a substantial piece of property. By showing these items separately, the statement allows users to determine if the government faced out-of-the-ordinary costs or if it resorted to atypical sources of financing in order to make ends meet. The following changes in net assets are also shown separately at the bottom of the statement as a source of financing the net cost of services: contributions to term and permanent endowments, contributions to permanent fund principal, and transfers between governmental and business-type activities.

The GASB's choice to require the reporting of depreciation for infrastructure assets was criticized in certain quarters as impractical. Most of the letters received as part of the due process that were referenced earlier in this chapter made this point. The GASB tried to address these

[4] It is interesting to note that the GASB introduced the extraordinary item category a few years before the FASB effectively eliminated its use for private-sector entities. Only time will tell if it will remain a part of the state and local government financial reporting model in the United States.

criticisms in part by establishing an alternative method of accounting and financial reporting in Statement 34 that was referred to as the “modified approach.” A government may use the modified approach for a network or subsystem of infrastructure assets if (1) the government uses an acceptable asset management system to manage them and (2) the assets are maintained at or above a specified physical condition level chosen by the government itself. The historical cost of these qualifying infrastructure assets is reported in the statement of net assets but is not depreciated. Rather, the costs of maintaining the assets and preserving them at their specified condition level are expensed annually. To date a significant number of state governments have adopted this approach. They have been joined by a few local governments who have qualifying asset management systems.

Fund Financial Statements

The advent of the new government-wide statements in Statement 34 did not mark the demise of fund accounting and reporting in the United States. Under Statement 34, fund statements conceptually are on an equal footing with the government-wide statements. This contrasts with the preference for consolidated reporting over fund reporting found in other countries. There was considerable sentiment among the GASB’s constituency—not only the community of financial statement users, but also preparers and auditors—that fund financial information would continue to be essential to understanding a government’s finances and should be retained. The GASB’s research further suggested that the usefulness of fund financial information, as currently presented, could be significantly improved.

Prior to Statement 34, governments presented the financial information in “combined” financial statements that grouped individual funds together by “fund type.” In other words, in the financial statements for the governmental funds, all of the capital projects funds were added together and shown in a single column, all of the debt service funds were added together and shown in one column, and so on. During the process of developing Statement 34, the GASB discovered that the intense interest among users in detailed fund financial information related primarily to individual funds rather than aggregated fund types. The ideal solution from a conceptual standpoint would have been to require the separate reporting of all individual funds in the basic financial statements. However, some governments employ dozens of funds in their day-to-day operations, thereby making this approach impractical. As a result, Statement 34 attempted to satisfy user needs without overwhelming readers with insignificant fund information. The result was replacing fund-type reporting with "major fund" reporting for the governmental and enterprise funds. Internal service funds and fiduciary funds still employ fund-type reporting.

Major fund reporting results in the most significant funds being displayed individually in the statements. Specifically, Statement 34 requires that the following funds be shown in their own columns:

- A government's main operating fund (usually its general fund).
- Any governmental or enterprise fund that fits both of the following criteria:
  - Total assets, liabilities, revenues, or expenditures/expense (not including extraordinary items) of the fund are at least 10 percent of the corresponding total for all funds (either all governmental or all enterprise, whichever is appropriate) *and*
  - Total assets, liabilities, revenues, or expenditures/expense (not including extraordinary items) of the fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined.
- Any other governmental or enterprise fund that a government believes is particularly important to the users of its financial statements. This criterion was established to meet the qualitative needs of users that could not be met purely by quantitative criteria.

The remaining "non-major" funds are combined and are shown in single columns for the governmental funds and for the proprietary funds. Many state and local governments in the United States that prepare a comprehensive annual financial report (CAFR) will also provide "combining" financial statements that display the non-major funds individually to supplement the basic statements and other information that is not included in the annual financial report requirements.

Governmental funds. The move to major fund reporting is far and away the most substantial change in fund reporting. Otherwise, the fund financial statements continue to provide much the same information. The governmental funds financial statements—the balance sheet (see Exhibit E on the following page) and the statement of revenues, expenditures, and changes in fund balances (see Exhibit F on the second page following this one)—are still prepared using the modified accrual basis of accounting and current financial resources measurement focus.

Exhibit E

Common County
Balance Sheet
Governmental Funds
June 30, 2002

	General Fund	Realignment Fund	Public Facility Corporation Debt Service	Other Governmental Funds	Total Governmental Funds
ASSETS					
Cash	$ 112,230	$ —	$ —	$ —	$ 112,230
Pooled cash and investments (Note 2)	36,419,118	5,098,741	—	9,303,983	50,821,842
Investments, plus accrued interest (Note 2)	—	—	11,343,051	3,354,153	14,697,204
Accounts receivable, net	184,054	—	7,250	1,700,251	1,891,555
Taxes receivable, net	1,500,000	—	—	500,000	2,000,000
Notes receivable, net	758,741	—	—	538,004	1,296,745
Due from other county funds (Note 4)	4,402,673	—	—	1,160,956	5,563,629
Due from other governments	19,240,733	1,911,880	—	6,312,187	27,464,800
Inventories	436,336	—	—	229,084	665,420
Prepaid items	139,699	—	—	217,000	356,699
Health plan contributions receivable, net	14,733,173	—	—	—	14,733,173
Total assets	$ 77,926,757	$ 7,010,621	$ 11,350,301	$ 23,315,618	$ 119,603,297
LIABILITIES AND FUND BALANCES					
Liabilities:					
Warrants payable	$ 6,365,060	$ —	$ —	$ 46,436	$ 6,411,496
Accounts payable	9,275,493	—	—	5,854,012	15,129,505
Due to other county funds (Note 4)	1,952,678	2,070,538	—	1,987,240	6,010,456
Due to other governments	3,715,414	—	—	—	3,715,414
Deposits from others	124,648	—	—	—	124,648
Salaries and benefits payable	2,903,176	—	—	311,688	3,214,864
Deferred revenue	10,364,468	4,940,083	—	516,000	15,820,551
Total liabilities	34,700,937	7,010,621	—	8,715,376	50,426,934
Fund balances:					
Reserved for:					
Inventories	436,336	—	—	229,084	665,420
Prepaid items	139,699	—	—	217,000	356,699
Noncurrent assets	15,491,914	—	11,350,301	538,004	27,380,219
Unreserved	27,157,871	—	—	—	27,157,871
Unreserved, reported in nonmajor:					0
Special revenue funds	—	—	—	7,274,422	7,274,422
Debt service funds	—	—	—	677,006	677,006
Capital project funds	—	—	—	5,664,726	5,664,726
Total fund balances	43,225,820	—	11,350,301	14,600,242	69,176,363
Total liabilities and fund balances	$ 77,926,757	$ 7,010,621	$ 11,350,301	$ 23,315,618	$ 119,603,297

Exhibit F

Common County
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2002

	General Fund	Realignment Fund	Public Facility Corporation Debt Service	Other Governmental Funds	Total Governmental Funds
REVENUES					
Property taxes	$ 31,312,479	$ —	$ —	$ 7,907,232	$ 39,219,711
Sales taxes	—	23,992,788	—	—	23,992,788
Motor fuel taxes	—	—	—	3,878,249	3,878,249
Licenses and permits	5,829,552	—	—	6,360	5,835,912
Fines, forfeitures, and penalties	6,718,777	—	—	6,587	6,725,364
Interest, rents, and concessions	3,490,156	—	829,148	1,097,604	5,416,908
Intergovernmental	230,436,074	—	—	27,137,411	257,573,485
Charges for services	39,868,067	—	—	2,465,827	42,333,894
Disaster costs recovered	—	—	—	790,082	790,082
Miscellaneous	4,754,254	—	—	985,530	5,739,784
Total revenues	322,409,359	23,992,788	829,148	44,274,882	391,506,177
EXPENDITURES					
Current:					
General government	18,810,638	—	—	464,123	19,274,761
Public protection	101,480,029	—	—	11,516,736	112,996,765
Public ways and facilities	—	—	—	15,171,844	15,171,844
Health and sanitation	59,158,818	—	—	2,487,543	61,646,361
Public assistance	156,561,061	—	—	15,268,543	171,829,604
Education	469,172	—	—	2,259,350	2,728,522
Culture and recreation	1,390,051	—	—	—	1,390,051
Debt service:					
Principal payments	1,692,345	—	3,270,000	9,455,096	14,417,441
Interest and fiscal charges	376,004	—	4,749,224	3,601,787	8,727,015
Debt issuance costs	—	—	813,954	—	813,954
Defeasance costs	—	—	4,347,462	—	4,347,462
Capital outlay	—	—	—	27,447,251	27,447,251
Total expenditures	339,938,118	—	13,180,640	87,672,273	440,791,031
Excess (deficiency) of revenues over expenditures	(17,528,759)	23,992,788	(12,351,492)	(43,397,391)	(49,284,854)
OTHER FINANCING SOURCES (USES)					
Capital leases	3,256,248	—	—	1,943,845	5,200,093
Certificates of participation issued	—	—	43,474,810	2,963,605	46,438,415
Premiums on debt issued	—	—	2,411,557	—	2,411,557
Payments to escrow agent	—	—	(41,875,000)	—	(41,875,000)
Transfers in (Note 4)	37,300,522	13,215,696	5,628,134	42,635,151	98,779,503
Transfers out (Note 4)	(42,473,518)	(37,208,484)	—	(18,991,501)	(98,673,503)
Total other financing sources and uses	(1,916,748)	(23,992,788)	9,639,501	28,551,100	12,281,065
Net change in fund balances	(19,445,507)	—	(2,711,991)	(14,846,291)	(37,003,789)
Fund balances—beginning	62,671,327	—	14,062,292	29,446,533	106,180,152
Fund balances—ending	$ 43,225,820	$ —	$ 11,350,301	$ 14,600,242	$ 69,176,363

The governmental funds still include the general fund, capital projects funds, debt service funds, and special revenue funds. Statement 34 created a new governmental fund type—"permanent funds." Permanent funds are nonexpendable public-purpose trust funds that formerly were reported with the fiduciary funds (for example, endowment funds where the principal of the endowment is not to be spent). Similarly, expendable public-purpose trust funds are now included among special revenue funds. These changes are logical given the GASB's reasoning for keeping the finances of the fiduciary activities separate from those of the governmental and business-type activities. Although these funds are trusts, their resources (or the earnings from their resources) *are* available to finance public programs, unlike the private-purpose nature of fiduciary funds.

A new feature of the governmental funds statements is a set of reconciling adjustments that explain how fund balance and change in fund balance differ from governmental activities net assets and change in net assets in the government-wide financial statements. These reconciliations will often appear at the bottom of the statement, but may also appear on a succeeding page. Some governments will also provide additional explanatory details of the reconciliation in the notes to their financial statements.

Proprietary funds. Proprietary funds continue to include two types—enterprise funds and internal service funds. The enterprise funds are generally the equivalent of the business-type activities reported in the government-wide statements. Statement 34 established a revised set of criteria for determining which activities should be reported as enterprise funds. Internal service funds are also activities operated in a business-like manner; however, their goods and services are provided primarily to the government or other governments, and not to the general public. In most cases the internal service funds are consolidated with the governmental activities in the government-wide financial statements and are therefore one of the reconciling entries in the governmental funds financial statements.

Statement 34 stipulates three financial statements for the proprietary funds, prepared on an accrual basis with an economic resources focus. Major enterprise funds are shown individually, non-major funds are combined, and the internal service funds are shown in a single fund-type column. The statement of revenues, expenses, and changes in fund net assets is arranged like an income statement, keeping operating income separate from nonoperating revenues and expenses and other changes in net assets. State and local governments are required to use the direct method for the statement of cash flows for proprietary funds.

Fiduciary funds. Unlike the governmental and proprietary funds, the fiduciary funds (for example, pension trust funds that are administered by the government) are not consolidated into the government-wide statements. They are reported in separate fiduciary fund financial statements that are prepared using accrual accounting and an economic resources measurement focus. The funds are aggregated by fund type in the statement of fiduciary net assets and statement of changes in fiduciary net assets. In practice, however, many governments may have only a single fund of a particular type and therefore would be reporting the funds individually.

Notes to the Financial Statements

Although the changes required by Statement 34 certainly have had a substantial impact on a government's note disclosures, the standard did not include a complete review of existing disclosure requirements. As noted earlier, the GASB comprehensively addressed note disclosure requirements in separate projects that resulted in two additional standards. The most significant new disclosures required by Statement 34 are those relating to capital assets and long-term debts.

The purpose of these notes is twofold: (1) To provide additional detail beyond the information shown on the face of the financial statement and (2) to show how capital assets and long-term liabilities changed over the course of the reporting period.

Required Supplementary Information

U.S. accounting standards stipulate that certain required supplementary information (RSI) should accompany the basic financial statements in a government's financial report. RSI often is presented in much greater detail and for more fiscal years than is practical in a note disclosure. An auditor's association with RSI does not approach the depth of examination applied to the basic financial statements, but nevertheless does entail some auditor review to determine if the required elements of the presentations have been provided.

The new financial reporting model incorporates several RSI presentations. The most significant of the new RSI presentations is management's discussion and analysis (MD&A). The Statement 34 RSI presentation also includes schedules that focus on the condition of infrastructure assets that the modified approach is applied to. Only governments using the modified approach will present this form of RSI. Finally, Statement 34 improves upon a third piece of RSI, the budgetary comparison. The MD&A and budgetary schedules are discussed in further detail below.

Management's Discussion and Analysis

As envisioned by the GASB, MD&A is intended to be a concise, objective introduction to a government's financial report and a summary analysis of the information contained in the statements. In addition to providing a guide to the organization of the financial report, MD&A offers condensed financial information derived from the financial statements. This information is accompanied by explanations from a government's finance officials, focusing on how the government's finances changed during the year.

Specifically, the analysis by the finance officials should explain:

- The government's overall financial position and results of operations, and significant changes in them, as well as presenting the governmental and business-type activities separately
- Significant balances, transactions, and changes in individual major funds, ,and limitations on the availability of fund resources for future use
- Significant budget variations
- Significant capital asset and long-term debt activity.

In addition, if a government employs the modified approach for reporting infrastructure, it should discuss in MD&A any significant changes in asset condition, how the actual condition compares with the government's chosen condition level, and any significant variances between estimated and actual maintenance and preservation expenses. Finally, MD&A also should address any facts or issues of which a government is aware as of the date of the auditor's report that are expected to significantly affect the government's finances.

Budgetary Comparisons

Statement 34 requires governments to prepare budgetary comparisons for the general fund and any special revenue fund for which the government has legally adopted an annual budget. (See Exhibit G on the next page.) The GASB encourages the presentation of the budgetary comparison as an RSI *schedule;* however, governments have the option to present the comparison as one of the basic financial statements. The GASB substantially improved the usefulness of the budgetary comparison by requiring the presentation of information from the originally adopted budget. Previously, governments presented just the final modified budget and actual results in a "combined statement of revenues, expenditures, and changes in fund balances—budget and actual." Variance columns (such as original budget to actual) may be included, but are optional. All governments that have legally adopted budgets for their governmental funds are required to present a reconciliation that describes the differences, if any, between the budgetary-basis information in the actual results column with the modified accrual information in the governmental funds statement of revenues, expenditures, and changes in fund balances.

Exhibit G

Common County
Budgetary Comparison Schedule
General Fund
For the Year Ended June 30, 2002

	Original Budget	Final Budget	Actual	Variance with Final Budget Positive (Negative)
REVENUES				
Taxes	$ 29,669,679	$ 31,231,241	$ 31,312,479	$ 81,238
Licenses and permits	5,392,960	5,676,800	5,829,552	152,752
Fines, forfeitures, and penalties	5,883,799	6,193,473	6,718,777	525,304
Interest, rents, and concessions	2,998,037	3,155,828	3,490,156	334,328
Intergovernmental	238,236,995	250,715,529	230,436,074	(20,279,455)
Charges for services	40,264,819	42,384,020	39,868,067	(2,515,953)
Miscellaneous	5,719,354	6,020,373	4,754,254	(1,266,119)
Total revenues	328,165,643	345,377,264	322,409,359	(22,967,905)
EXPENDITURES				
Current:				
General government:				
Assessor	2,708,683	2,851,245	2,728,917	122,328
Auditor-controller	1,028,213	1,008,052	927,090	80,962
Board of supervisors	557,709	587,062	580,669	6,393
County administrative	737,314	722,857	698,787	24,070
County counsel	4,260,945	4,485,205	4,426,039	59,166
Information technology	1,280,908	1,255,792	1,074,122	181,670
Miscellaneous administration	2,746,957	2,891,534	2,254,920	636,614
Personnel	479,781	470,374	408,213	62,161
Purchasing	3,088	3,250	2,309	941
Resource management	3,940,377	3,863,115	3,661,319	201,796
Retirement	761,440	801,516	643,754	157,762
Treasurer-tax collector	1,560,730	1,530,127	1,404,499	125,628
Public protection:				
Agriculture commissioner	3,606,052	3,795,844	3,597,080	198,764
Assessor	1,291,266	1,265,947	1,133,311	132,636
Auditor-controller	1,112,467	1,171,018	1,045,741	125,277
District attorney	23,139,324	22,685,612	20,026,319	2,659,293
Drug and alcohol abuse testing	66,500	70,000	18,962	51,038
Local law enforcement	890,581	873,119	794,008	79,111
Miscellaneous administration	1,742,414	1,834,120	925,729	908,391
Multi-agency gang violation program	638,995	626,466	365,346	261,120
Probation	14,460,674	15,221,762	14,294,893	926,869
Public defender	4,389,390	4,303,324	4,136,480	166,844
Resource management	4,840,736	5,095,512	4,380,393	715,119
Rural crime	806,268	790,459	729,753	60,706
Sheriff-coroner	39,891,405	41,990,953	41,348,203	642,750
Trial courts	9,117,370	8,938,598	8,683,811	254,787
Health and sanitation:				
District attorney	145,033	152,666	141,230	11,436
Health and human services	63,107,436	65,791,604	58,547,745	7,243,859
Miscellaneous administration	510,723	537,603	469,843	67,760
Public assistance:				
Health and human services	165,275,761	173,972,485	156,013,910	17,958,575
Miscellaneous administration	470,214	462,994	462,637	357
Education:				
Cooperative extension	446,010	469,484	469,172	312
Culture and recreation:				
Parks and recreation	1,508,342	1,587,728	1,390,051	197,677
Debt service:				
Principal payments	1,777,581	1,777,581	1,776,859	722
Interest and fiscal charges	406,308	406,308	376,004	30,304
Total expenditures	359,706,995	374,291,316	339,938,118	34,353,198
Excess (deficiency) of revenues over expenditures	(31,541,352)	(28,914,052)	(17,528,759)	11,385,293
OTHER FINANCING SOURCES (USES)				
Capital leases	8,877,698	8,877,698	3,256,248	(5,621,450)
Transfers in	37,300,522	37,260,172	37,300,522	40,350
Transfers out	(42,473,518)	(39,466,682)	(42,473,518)	(3,006,836)
Total other financing sources (uses)	3,704,702	6,671,188	(1,916,748)	(8,587,936)
Net change in fund balances	(27,836,650)	(22,242,864)	(19,445,507)	2,797,357
Fund balances—beginning	59,665,291	62,671,327	62,671,327	—
Fund balances—ending	$ 31,828,641	$ 40,428,463	$ 43,225,820	$ 2,797,357

CHAPTER THREE—IMPLEMENTATION ISSUES ASSOCIATED WITH THE ADOPTION OF ACCRUAL ACCOUNTING

After the release of Statement 34 in 1999, the GASB allowed for an extended implementation period. The state governments and the largest local governments (those with total annual revenues of $100 million or more) were given three years to implement, medium-sized local governments were provided with a four-year implementation period, and small local governments (those with total revenues of less than $10 million) were allowed a five-year implementation period. An additional transition period was provided for existing infrastructure assets that previously had not been required to be reported. Although small governments faced fewer challenges in regard to implementation issues, capacity concerns and the cost associated with implementation led the GASB to introduce this tiered implementation scheme.

The list of challenges that were faced by governments over the past six years as they implemented the new accrual accounting model was quite extensive. Perhaps the four most challenging implementation issues were capital assets, eliminations, classifications, and MD&A. Another issue, the timeliness of financial reports, is not directly within prevue of the GASB; however, governments still struggle to issue their financial statements within six months of the fiscal year end. Of course to be useful, financial reports need to be timely.

Not all of these issues rise to the level of a technically challenging accrual entry. Even though the prior use of the modified accrual basis of accounting required governments to calculate all long-term liabilities and report them in the general long-term debt account group, governments did not previously allocate the associated costs (for example, allocating long-term employee benefit costs to the appropriate program).

Capital Assets

There were many specific issues associated with the reporting of capital assets, the integrity of existing capital assets records and development of infrastructure and depreciation records leading the list. Some local governments had audit qualifications associated with the general fixed assets account group before the implementation of the new financial reporting model; however, when the reality set in that capital assets would have direct impact on the bottom line, many governments discovered that a significant amount of work needed to be devoted to existing capital assets records before issues such as infrastructure and depreciation could even be considered. To help deal with this issue, many governments reconsidered their capitalization thresholds. Even in the days of multi-million or even multi-billion dollar budgets, some governments had capitalization thresholds as low as $50. Some governments raised these thresholds substantially to focus on fewer items without materially affecting the amounts reported in the financial statements.

As previously noted, with the exception of enterprise funds, internal service funds, and pension trust funds, prior to the implementation of Statement 34, state and local governments in the United States did not report depreciation of fixed assets. Therefore, governments had to not only document when the asset was acquired (many governments did not have this information in their financial systems), but also determine the useful lives of those assets. Standardized useful lives were developed by other organizations; however, the GASB encouraged governments to assess useful lives based on each government's own experience. For example, fixed assets, such as roads, in one region of the country may have much longer or shorter lives than the same type of asset in other regions.

One more issue added by the introduction of depreciation for general government assets was the identification of the proper program expense classification. Additional classification issues are discussed below. Although these processes are not difficult from a technical standpoint, it was time consuming for many of those governments.

As noted earlier, the required reporting of general infrastructure assets was the most controversial provision of the new financial reporting model. Most state and local government financial systems did not contain required information related to those assets. To assist governments in their transition, the GASB allowed them to estimate historical cost for existing general infrastructure assets in cases where the government did not have adequate records to determine the actual historical cost. Governments also used other information, such as bond prospectuses, to estimate the historical cost of the assets, or to establish current replacement cost and deflate it back to the year in which the assets were constructed, renovated, or purchased. Because of inflation factors in the United States and replacement cycles, the GASB established a 1980 minimum look-back period for the retroactive reporting of general infrastructure assets.

This date also coincided with the effective date of National Council on Governmental Accounting (NCGA) Statement 1, *Governmental Accounting and Financial Reporting Principles,* which required infrastructure asset records to be maintained but, as noted earlier, did not require those assets to be reported in the financial statements. The final transition provision to assist governments was the allowance of an additional four-year transition period to reflect the required information in the basic financial statements. Because of outstanding debt associated with assets, many governments did not avail themselves of this provision. They did not want to report a deficit in the capital assets, net of related debt section of the net assets. However, many governments have taken advantage of this full additional transition period.

Either during the initial transition period or during the additional four-year period, governments have taken several approaches to gathering data on general infrastructure assets. Some financial report preparers found that their department of transportation (for state governments) or public works department (for local governments) had useful records containing acquisition, construction, and improvement information. Others even had historical cost information. Some governments found information at the state and federal levels that proved to be of assistance with this effort. Finally, some governments hired appraisal firms to help construct inventory and cost records. Although some governments are not expected to make the effort to report retroactive general infrastructure assets, the GASB felt that this information was essential to determining the cost of providing service.

Those governments that do not provide that information receive either an adverse or a qualified audit opinion on their financial statements.

Classifications

Another issue that generally is considered a one-time transition issue is classification of accounts. The GASB introduced several new reporting categories with the model that resulted in governments' analyzing their accounts to determine the proper classifications. Classification decisions are not technically challenging; however, due to the number of decisions that needed to made, it proved to be quite time consuming for many governments.

Decisions that needed to be made included determining whether governmental revenues should be reported as program revenue or as general revenue. If a revenue is determined to be program revenue, it should be reported within the appropriate program as a factor in determining net program cost. Net assets also needed to be classified into three categories: capital assets, net of related debt; restricted net assets (divided between permanent and temporary restrictions); and unrestricted. Certain debt classifications and assessing restrictions proved to be problematic in making those classification decisions.

Because the GASB retained fund reporting in the new state and local government model, many governments have chosen to maintain their accounting system on either a modified accrual or budgetary basis during the year and then make various accrual adjustments and reclassifications at the end of the reporting period. To assist state and local governments with implementation issues, including classification questions, the GASB released two implementation guides and two clarifying standards.

Eliminations

For U.S. governments that previously had not produced entity-wide financial statements, the use of elimination entries was a new challenge. Even for those with experience in the private sector, the exercise is different. This results from two factors that were previously introduced: the use of two columns in the government-wide financial statements and the focus on cost-of-service information. Because of the two-column-statement approach (three columns when component units are discretely presented), not all intra-entity activities are eliminated as would be expected with a traditional consolidation. In addition, certain intra-entity transactions within a column (for example, governmental activities) are not eliminated, so that program revenues and expenses are not understated.

Again, eliminating entries are not considered to be technically challenging; however, when they are introduced into a financial reporting model, additional time is needed to identify the internal transactions and events and to determine the extent to which elimination is required.

MD&A

MD&A, as outlined in Chapter 2, is intended to be an unbiased, objective, and factual analysis of the government's financial position and changes in financial position for the period. The biggest challenge associated with the preparation of the MD&A has been the natural tendency to prepare an MD&A that primarily focuses the positives and minimizes any negative information.

The GASB has no direct enforcement powers, and because the MD&A is classified as RSI, even the lack of an MD&A does not affect the auditor's opinion. So how has the MD&A remained a credible source of information? Primarily through the professionalism of the finance officials that prepare the MD&A. Many have withstood political challenges by using the guidance issued by the GASB, GFOA, and others. That guidance has helped provide the support that was needed for those finance officials to stand up to political pressures. In the end, it still falls to the finance official to face the problem and provide financial statement users with an unbiased view of the information being reported.

CHAPTER 4—U.S. ACCRUAL STANDARDS IN AN INTERNATIONAL CONTEXT

One may ask a number of questions regarding the evolution of accrual accounting in the United States from an international standpoint. Where is the International Public Sector Accounting Standards Board (IPSASB) in this process? What role did accrual basis standards of other countries play in the process? To gain a proper perspective on the role of international standards, one should reflect on the time line. Both the GASB and FASAB issued their accrual-based standards in the 1990s. In contrast, International Public Sector Accounting Standard (IPSAS) 1, *Presentation of Financial Statements,* was not issued until 2000. Still, in many respects, as noted in Chapter 2, the governmental financial reports required by the GASB and FASAB are substantially similar to those developed by the IPSASB and its predecessor. Each requires financial statements prepared on an accrual basis that encompass the entire governmental entity. Clearly there are some differences, most notably the continuation of fund reporting in the GASB financial reporting model. Nonetheless, on the whole one can observe that there is notable agreement in the fundamental requirements of the U.S. and the IPSASB financial reporting models.

One may categorize the differences that do exist in three ways—conceptual, developmental, and technical. The preceding parts of this paper identified several technical features of U.S. financial reporting that differ from the IPSASB standards. This chapter considers a key difference in the otherwise very similar conceptual underpinnings of U.S. and international standards setting, as well as the markedly different circumstances and environments in which the respective standards were developed.

There is considerable congruence in the basic conceptual foundations of standards setting in the United States and abroad. For example, the comparison in Exhibit H (on the next page) of the objectives of financial reporting set forth in GASB Concepts Statement 1, FASAB Concepts Statement No. 1, *Objectives of Federal Financial Reporting,* and IPSAS 1 (paragraphs 13-16).

Exhibit H Comparison of GASB, FASAB, and IPSASB Financial Reporting Objectives

Governmental Accounting Standards Board	Federal Accounting Standards Advisory Board	International Public Sector Accounting Standards Board
	Financial reporting should:	
…demonstrate whether resources were obtained and used in accordance with the entity's legally adopted budget; it should also demonstrate compliance with other finance-related legal or contractual requirements. …disclose legal or contractual restrictions on resources and risks of potential loss of resources.	…provide information that helps the reader determine how resources have been obtained and used and whether their acquistion and use were in accordance with the legal authorization. …provide information that helps the reader determine the status of budgetary resources. …provide information that helps the reader determine how information on the use of budgetary resources relates to information on the costs of program operations and whether information on the status of budgetary resources is consistent with other accounting information on assets and liabilities.	Indicating whether resources were obtained and used in accordance with the legally adopted budget. Indicating whether resources were obtained and utilized in accordance with legal and contractual requirements, including financial limits established by appropriate legislative authorities.
…provide information to assist users in assessing the service efforts, costs, and accomplishments of the governmental entity.	…provide information that helps the reader determine the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs.	Providing aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency and accomplishments.
…provide information about sources and uses of financial resources.	…provide information that helps the reader determine the costs of providing specific programs and activities and the composition of, and changes in these costs.	Providing information about the sources, allocation, and uses of financial resources.
…provide information about how the governmental entity financed its activities and met its cash requirements.		Providing information about how the entity financed its activities and met its cash requirements.
…provide information necessary to determine whether the entity's financial position improved or deteriorated as a result of the year's operations. ...provide information to determine whether current-year revenues were sufficient to pay for current-year services. …provide information about the financial position and condition of a governmental entity.	…provide information that helps the reader to determine whether the government's financial positon improved or deteriorated over the period. …provide information that helps the reader to determine whether government operations have contributed to the nation's current and future well-being. …provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.	Providing information about the financial condition of the entity and changes in it. Providing information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and committments Provide information about assets, liabilities, net assets/equity, revenue, expenses, and cash flows.
…provide information about a governmental entity's physical and other nonfinancial resources having useful lives that extend beyond the current year, including information that can be used to assess the service potential of those resources.	…provide information that helps the reader to determine the efficiency and effectiveness of the government's management of its assets and liabilities.	
	…assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate..	

Sources: GASB Concepts Statement 1, FASB Concepts Statement 1, and IPSAS 1.

Other conceptual aspects of the accounting standards also bear strong similarities. The community of users of government financial statements, while not identical, is strikingly similar. The same may be said of the respective inventories of financial reporting's qualitative characteristics.

A more likely conceptual determinant of divergence in standards may be the perceived relationship between private-sector and public-sector accounting and reporting. As noted in Chapter 1, the basic tenet of U.S. standards setting has been that governments are decidedly different in purpose from business enterprises, relate to their "stakeholders" differently, and are accountable for a much broader and more complex array of issues than are businesses enterprises. Although there are some notable similarities in the ways that business enterprises and business-type activities in state and local governments report their finances, the government as a whole is considered an entirely different kind of entity.

Another pertinent explanation of differences in standards, as well perhaps of differences in the conceptual connection between public- and private-sector financial reporting, may be the political and governmental environment in which they were developed. As noted in Chapter 1, the centrality of the annual budget cycle to the political and administrative processes in U.S. state and local governments has had a substantial impact on how finances are accounted for and reported. Governmental accounting and reporting in the United States is heavily influenced by the budgetary and managerial control practices of state and local governments. The ingraining of this prior experience played a prominent role in the crafting of GASB Statement 34, most notably in the retention of fund reporting and budgetary comparison information.

Furthermore, the process that produced Statement 34 focused only on financial reporting and did not encompass budgeting and other aspects of financial management. These other practices remained constant. In fact, the establishment of budgetary standards beyond reporting requirements is clearly outside the GASB's scope of responsibilities. It should be noted that the IPSASB released an Exposure Draft in 2005 that, if adopted, would required the reporting of budgetary comparison information. The IPSASB chose an approach similar to that previously set forth by the GASB, including proposing not to address budgetary policy issues.

CHAPTER FIVE—THE AFTERMATH OF THE NEW REPORTING MODEL

The experience after the publication of Statement 34 taught the GASB a number of lessons that should be instructive for future standards setting in the United States and elsewhere. This section discusses some of the events following the issuance of Statement 34 and the lessons learned.

Lesson One: The Role That Publicity Plays

The corporate accounting scandals and subsequent reforms under the Sarbanes–Oxley Act (which does not apply to governments) have been prominently covered in the U.S. news media in recent years. However, even without scandals and reforms, business enterprises and related accounting reforms dominate the news. Governmental accounting, however, typically does not garner the attention of mainstream news outlets, unless something goes terribly wrong, such as the threatened bankruptcy of New York City in 1974 or the bankruptcy filing of Orange County, California, in 1994. The release of new governmental standards in the United States, if their impact is significant, generally is noted only in some accounting industry publications and the periodicals of major GASB constituent organizations such as the AICPA, the GFOA, or the National Association of State Auditors, Comptrollers and Treasurers (NASACT).

The issuance of Statement 34 was a rare exception. Coverage by the *New York Times* (front page, above the fold—a major achievement in the United States), *Wall Street Journal*, and television network CNN elevated the GASB's visibility to previously unseen heights. The news accounts were full of praise for the new required financial statements. A nationally syndicated columnist referred to the day of the Board's vote to approve Statement 34 as "a historic day for the cause of honesty and straightforwardness in how America's state and local governments handle our money."[5] A representative of a professional organization for government researchers

[5] Neal Pierce, "Better Accounting for More Honest Politics," http://www.postwritersgroup.com/archives/peir0614.htm, June 21, 1999.

called Statement 34 a "major step in the right direction,"[6] an opinion echoed in other corners of the user community.[7]

The notice accorded Statement 34 was also spurred on by controversy. Strong opposition to the reporting of infrastructure assets, particularly among local government finance officers, added interest to the story. Statement 34 was not only "the most significant change to occur in the history of governmental financial reporting,"[8] according to then-GASB chairman Tom Allen, it was also characterized as a "firestorm" debate between the Board and its critics.[9]

As a public relations tool, controversy is a double-edged sword. On the one hand, controversy can bring attention to an otherwise mundane story that might attract scant interest. On the other hand, it is never pleasant to stand in the face of severe public criticism. More importantly, the emotions that are generated by such controversy can spill over and threaten the independence of the standards-setting body, not to mention its very existence.

During the Board's deliberations, some major constituent organizations considered withholding their funding support of the GASB because of disagreements over certain provisions of the new model. Although these threats never came to fruition, a certain level of animosity still lingers for some of GASB's constituents.

Lesson Two: Education and Implementation Assistance Are Essential

It may be argued that much of the alarm raised by local government officials regarding the reporting of infrastructure assets resulted from incomplete and incorrect information. Although the Board members and staff of the GASB made hundreds of presentations annually to a wide variety of constituent organizations in the last few years leading up to the release of Statement 34, many thousands of preparers and auditors did not attend those conferences and seminars. Although the GASB expended considerable effort to educate its constituents about what Statement 34 would entail, perhaps more could have been done.

---

[6]Melody Petersen, "Putting a Price on the Brooklyn Bridge: Local Governments May Have to Operate More Like Businesses," *The New York Times,* June 6, 1999.
[7]Richard A. Ciccarone, "GASB's New Reporting Standard Will Help Governments," *The Bond Buyer,* July 12, 1999, p. 27. Robert M. Reardon, Jr., "GASB's Statement 34 Is a Step in the Right Direction," *The Bond Buyer,* August 9, 1999, p. 36.
[8]"GASB Approves Most Significant Change in History of Government Financial Reporting," www.dowjones.com, June 10, 1999.
[9]Melody Petersen, *op. cit.*

The GASB's endeavors were certainly not aided by the misinformation that at times seemed to abound about the nature of Statement 34's requirements. This was a particular concern for the infrastructure requirements. Although the GASB had responded to the concerns of its constituents by adopting multiple transition provisions intended to greatly ease the implementation of this part of Statement 34, some observers continued to claim that governments would have to construct massive asset inventories to account for every single asset, no matter how insignificant.

Before Statement 34 was completed, the GASB mapped out an extensive public relations and educational campaign built upon a combination of public appearances, publications, and official implementation guidance. From 1999 to 2001, the GASB chairman and staff made approximately 300 speeches and presentations to virtually every type of constituent organization. The general response from the audiences was concern about the effort and cost required to implement Statement 34, but also tremendous relief that it was not nearly as onerous as they had been led to believe. In the end, more than 2,500 governments implemented Statement 34 at least one year *prior* to their required deadline.

The GASB attempted to ensure that there was adequate implementation assistance available to its constituents. Within two years the GASB had published two implementation guides to Statement 34—containing 500 questions with detailed answers, more than 100 illustrative financial statements and note disclosures, and exercises.[10] These implementation issues were identified through a number of sources including the GASB's advisory council and technical inquiries received by staff members. GASB staff developed a detailed training course on Statement 34 that was provided to an external publisher. GASB also reviewed implementation materials that were being prepared by major professional organizations.

The GASB also ventured in a new area, publishing a series of seven "user guides" related to the new financial reporting model. These guides, written in a nontechnical, plain-language style, did not address the nuts and bolts of how to implement Statement 34, but rather explained the value of the information the new financial reports would contain and how that information could be used to make decisions and to assess a government's financial health. Three guides

[10] *Guide to Implementation of GASB Statement 34 on Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* and *Guide to Implementation of GASB Statement 34 and Related Pronouncements.*

were written for persons with no prior knowledge of government accounting or finance[11] and a fourth was written for more experienced analysts.[12] Finally, three very brief "quick" guides were prepared especially for board members and elected officials.[13]

Although intended primarily for users, a large number of guides were acquired by preparers and auditors, who were looking for assistance in how to explain to their elected officials, clients, and constituents the importance and value of the new financial reporting model. When this interest in the user guides became apparent, the GASB began to market the guides in finance director packages—a full guide accompanied by 10 quick guides.

The GASB's education efforts are an essential part of its mission, which encompasses not only the promulgation of standards, but also the education of the public about those standards. With the publication of so far-reaching a standard as Statement 34, it was more important than ever for the GASB to make clear that it understood the effort that would be required to comply, and that it was making an enormous effort of its own to help make the transition easier for governments.

The release of Statement 34 was also looked upon by the GASB as a rare opportunity to introduce itself to parts of the public it normally would have little contact with, but to whom the GASB could nevertheless be quite valuable. The occasion of introducing a new financial reporting model for governments was an event of interest to many groups that otherwise would pay little or no attention to the GASB's activities. In addition, the GASB also published dozens of articles in the journals and periodicals of many professional organizations.

Finally, the GASB viewed Statement 34 as an opportunity to emphasize, even to its most intimately involved constituent groups, its independent structure and objective process. The decisions surrounding the reporting of infrastructure, as well as many other features of the standards, were case studies in the inner workings of due process—meaningful demonstrations of how public input plays a crucial role in the development of governmental accounting standards. The GASB made a conscious effort to emphasize these issues each time it was given

---

[11]Dean Michael Mead, *What You Should Know about Your Local Government's Finances, What You Should Know About Your School District's Finances, What* Else *You Should Know About a Government's Finances—A Guide to Notes to the Financial Statements and Supporting Information.* Norwalk, CT: GASB, 2000. 2001, and 2005.
[12]Dean Michael Mead, *An Analyst's Guide to Government Financial Statements.* Norwalk, CT: GASB, 2001.
[13]Dean Michael Mead, *The Quick Guide to Local Government Financial Statements, The Quick Guide to State Government Financial Statements,* and *The Quick Guide to School District Financial Statements.* Norwalk, CT: GASB, 2001.

an opportunity to speak with a constituent organization or write an article for one of its publications.

Lesson Three: Be Alert to the Potential for Standards Overload

A significant amount of the GASB's efforts over a 15-year period were devoted to developing the financial reporting model. Even after Statement 34 was released, the GASB staff focused a significant amount of effort on implementation issues. Once a major project like Statement 34 is finished, it has the effect of unclogging a pipeline. A number of projects had been postponed to concentrate the GASB's time on the financial reporting model. One of the most notable was retiree healthcare benefits—one of the most significant unreported obligations of many state and local governments.

There is a natural tendency to try to quickly deal with outstanding issues, and the GASB has done its part by issuing standards on note disclosures, asset impairment, the fore mentioned retiree healthcare benefits, and termination benefits. In addition, progress is being made on derivatives accounting, pollution remediation obligations, intangible assets, and completing the conceptual framework. Realizing that the financial reporting model is not a typical standard, the GASB has considered the effort necessary to implement this major standard. The effective dates of subsequent standards that were not directly related to the financial reporting model have been established with that effort in mind. The same policy is also being used for the retiree benefits standards.

Conclusion

This paper is not intended to advocate the use of any U.S.-based financial reporting model. International standards are in the capable hands of the IPSASB. Hopefully, the paper has provided some insight into the government environment in the United States and how standards setters, especially the GASB, have responded.

The goal of issuing accrual accounting–based financial statements is not an easy one; however, with constituent participation in the development of those statements through task forces, focus groups, field tests, and other forms of due process it can be accomplished.

APPENDIX A—FEDERAL FINANCIAL REPORTING[14]

In its first concepts statement, *Federal Financial Reporting Objectives*, the FASAB presents its views on the unique nature of government and the limitations of financial reporting, and identifies users and four reporting objectives. Significant aspects of the concepts are that (1) both internal and external users are served by financial reports, and (2) accounting standards may improve information outside of general purpose financial reports (for example, that the objectives and measures established may be useful for some aspects of special reporting).

In the preamble to the reporting objectives, FASAB summarized its views on the unique nature of government, limitations of financial reports, users and improvements to data generally:

> 105. The federal government derives its just powers from the 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 people, their elected representatives and federal executives. Providing this information to the public, the news media and elected officials is an essential part of accountability in government. Providing this information to program managers, executives and members of Congress is essential to planning and conducting the government's functions economically, efficiently and effectively for the benefit of society.
>
> 106. 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. Financial reporting can, however, make a useful contribution toward those objectives.
>
> 107. The objectives discussed below apply both to internal and to external financial reports. To some degree, they also apply both to special purpose and to general purpose reports. Users of general purpose financial reports may have difficulty obtaining relevant information to hold the federal government accountable if the government operates

[14]The authors would like to recognize the contributions of federal government officials for their work on this appendix.

without appropriate reporting objectives and accounting standards. The board also intends that these objectives and the ensuing standards will prove widely useful for other purposes, though they may not apply to every special report or every item in the accounting system. The objectives are intended to improve the relevance, consistency and quality of accounting and other data available for a wide variety of applications.

The concepts statement establishes four reporting objectives (as highlighted in Exhibit H in Chapter 4). The reporting objectives relate to the federal government's management and financial reporting systems in their entirety. For example, extensive budgetary reporting is required by law and regulation. Thus, it is feasible that sources of information other than general purpose financial reports contribute to meeting objectives and that the FASAB will not address every objective and sub-objective. The FASAB is currently reviewing the reporting objectives and may clarify its role relative to certain objectives through future concepts statements or a strategic plan.

The four reporting objectives are presented below:

Budgetary Integrity—Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations.

Operating Performance—Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

Stewardship—Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.

Systems and Control—Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate.

The principal financial statements for federal component entities[15] are:

1. **Balance Sheet—**The balance sheet presents, as of a specific time, amounts of future economic benefits owned or managed by the reporting entity (assets), amounts owed by the entity (liabilities) and the difference (net position).
2. **Statement of Net Cost—**The Statement of Net Cost presents and disaggregates the net cost of operations of an entity for a given period. The statement displays the gross cost of major programs by sub-organization, matches the exchange revenue earned with the gross costs, and arrives at the net cost. Costs that cannot be assigned to specific outputs or programs and exchange revenues that cannot be attributed to specific outputs or programs are presented separately.[16]
3. **Statement of Changes in Net Position—**The Statement of Changes in Net Position presents the net results of operations for the period, other adjustments to cumulative results of operations made during the period, and the increase/decrease in unexpended appropriations. "Net results of operations" is the excess of financing sources over net cost of operations for the period.[17] Financing sources include nonexchange revenue and appropriations used as well as donations and transfers in. The net results of operations and any other adjustments to cumulative results of operations—such as prior period adjustments—together are the "net change in cumulative results of operations" for the period. The last component of "change in net position" is the increase or decrease in unexpended appropriations.[18]

[15]The Consolidated Financial Report of the U.S. Government (CFR) presents consolidated whole of government statements that differ somewhat from component entity-level statements. For each principal financial statement described below, a footnote will identify any significant consolidated financial statement differences. (The CFR is available on the Internet at http://www.fms.treas.gov/fr/index.html.)

[16]The CFR presents net cost information by major department, and not by program.

[17]The term *net results of operations* no longer appears on the face of component entity Statements of Changes in Net Position. Instead, the cumulative results of operations at the beginning of the period is adjusted for the period's net cost and financing sources to arrive at the ending cumulative results of operations. This departure from the label "net results of operations" emphasizes that this amount is not directly equivalent to the same term in other sectors. Nonetheless, a new term has not been substituted, so *net results of operations* is still used as a means to refer to the amount.

[18]The CFR presents a Statement of Operations and Changes in Net Position. Appropriations are not a source of financing the government as a whole, so no information on appropriations is presented.

4. **Statement of Budgetary Resources—**The Statement of Budgetary Resources and related disclosures provide information about how budgetary resources were made available and their status at the end of the period. Budgetary information reported in the Statement of Budgetary Resources is based on budgetary accounting rules and is required to be presented in the format prescribed for the Report on Budget Execution and Budgetary Resources. This statement results in budget execution information being subject to audit. Some have concluded that this has resulted in more accurate reporting on budget execution.[19]
5. **Statement of Financing—**The Statement of Financing presents the reconciliation of accrual accounting based results and budgetary results. It was developed to assist readers in understanding the differences between net cost under GAAP and budgetary obligations. In addition, it presents information not available elsewhere. For example, it reports the net change in obligations for undelivered orders.[20]
6. **Statement of Custodial Activity—**The Statement of Custodial Activity is required for reporting entities that collect material amounts of nonexchange revenue (or other resources) on behalf of the general fund of the Department of the Treasury, a trust fund or other recipient agencies. Reporting entities meeting these requirements present the sources and disposition of these collections in the Statement of Custodial Activity. Amounts reported on the statement of custodial activity are not reported as "revenue" by the collecting entity – instead, revenue is recognized by the entity receiving the proceeds.[21]

[19]The CFR does not present a Statement of Budgetary Resources since budgetary resources are provided to component entities.

[20]The CFR does not present a Statement of Financing. Since the budget deficit or surplus is the key budgetary amount from the government-wide perspective and the change in cash is a significant amount from an economic perspective, the CFR provides two additional statements. The Reconciliation of Net Operating Revenue (or Cost) and Unified Budget Surplus (or Deficit) explains differences between the accrual-based operating results and the budget's deficit or surplus for the year. The Statement of Changes in Cash Balance from Budget and Other Activities explains the differences between the budget deficit or surplus and the changes in cash held by the government.

[21]The CFR does not present a Statement of Custodial Activity since this relates primarily to intra-government activity.

7. **Statement of Social Insurance –** FASAB identified five characteristics common among social insurance programs:

   (1) Financing from participants or their employers,
   (2) Eligibility from taxes/fees paid and time worked in covered employment,
   (3) Benefits not directly related to taxes/fees paid,
   (4) Benefits prescribed in law, and
   (5) Programs intended for the general public.

   The federal government's social insurance programs are Social Security (Old-Age, Survivors, and Disability Insurance), Medicare (Hospital Insurance [Part A] and Supplementary Medical Insurance [Part B]), Railroad Retirement benefits, Black Lung benefits, and Unemployment Insurance. Social insurance programs blend elements of exchange and nonexchange transactions and are considered by some to be difficult to adequately report on through traditional financial statements. Because many taxpayers may rely on social insurance programs in their long-term planning, fundamental questions about social insurance programs include (1) whether they are sustainable as currently constructed and (2) what their effect on the government's financial condition will be. The Statement of Social Insurance presents the actuarial present values of (i) future benefits and (ii) contributions and tax income for social insurance programs. Beginning in fiscal year 2006, this statement will be an additional principal financial statement. Until that time, the statement remains required supplementary stewardship information.

With respect to exchange transactions, federal accounting is accrual basis. For example, federal employee pension and other post-employment benefits are accrued as service is provided. In addition, long lived assets are capitalized and depreciated when appropriate.

The FASAB is currently working on a comprehensive conceptual framework and considering further issues related to accrual accounting for non-exchange liabilities. One aspect of FASAB's work on the conceptual framework is considering whether the current reporting model meets the objectives established. Some respondents believe the model is not yet complete and that FASAB should devote resources to developing reports on the sustainability of government programs. In addition to the reporting model, FASAB continues to address specific issues such as appropriate accruals for social insurance programs, questions related to quasi-federal entities not currently consolidated, and lease accounting.

APPENDIX B—STATEMENTS OF THE GOVERNMENTAL ACCOUNTING STANDARDS BOARD

The following are the Statements that have been issued by the Governmental Accounting Standards Board through December 31, 2005.

Statement No. 1, *Authoritative Status of NCGA Pronouncements and AICPA Industry Audit Guide*

Statement No. 2, *Financial Reporting of Deferred Compensation Plans Adopted under the Provisions of Internal Revenue Code Section 457*

Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*

Statement No. 4, *Applicability of FASB Statement No. 87, "Employers' Accounting for Pensions," to State and Local Governmental Employers*

Statement No. 5, *Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers*

Statement No. 6, *Accounting and Financial Reporting for Special Assessments*

Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*

Statement No. 8, *Applicability of FASB Statement No. 93, "Recognition of Depreciation by Not-for-Profit Organizations," to Certain State and Local Governmental Entities*

Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*

Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*

Statement No. 11, *Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements*

Statement No. 12, *Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers*

Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*

Statement No. 14, *The Financial Reporting Entity*

Statement No. 15, *Governmental College and University Accounting and Financial Reporting Models*

Statement No. 16, *Accounting for Compensated Absences*

Statement No. 17, *Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements: Amendment of the Effective Dates of GASB Statement No. 11 and Related Statements*

Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*

Statement No. 19, *Governmental College and University Omnibus Statement (an amendment of GASB Statements No. 10 and 15)*

Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*

Statement No. 21, *Accounting for Escheat Property*

Statement No. 22, *Accounting for Taxpayer-Assessed Tax Revenues in Governmental Funds*

Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*

Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*

Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*

Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*

Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*

Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*

Statement No. 29, *The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities*

Statement No. 30, *Risk Financing Omnibus*

Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*

Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*

Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*

Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*

Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*

Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues*

Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*

Statement No. 38, *Certain Financial Statement Note Disclosures*

Statement No. 39, *Determining Whether Certain Organizations Are Component Units*

Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*

Statement No. 41, *Budgetary Comparison Schedules—Perspective Differences (an amendment of GASB Statement No. 34)*

Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*

Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*

Statement No. 44, *Economic Condition Reporting: The Statistical Section (an amendment of NCGA Statement 1)*

Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*

Statement No. 46, *Net Assets Restricted by Enabling Legislation (an amendment of GASB Statement No. 34)*

Statement No. 47, *Accounting for Termination Benefits*

APPENDIX C—STATEMENTS OF THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The following are the Statements that have been issued by the Federal Accounting Standards Advisory Board through December 31, 2005.

Statement 1, *Accounting for Selected Assets and Liabilities*
Statement 2, *Accounting for Direct Loans and Loan Guarantees*
Statement 3, *Accounting for Inventory and Related Property*
Statement 4, *Managerial Cost Accounting Concepts & Standards*
Statement 5, *Accounting for Liabilities of the Federal Government*
Statement 6, *Accounting for Property, Plant & Equipment (PP&E)*
Statement 7, *Accounting for Revenue and Other Financing Sources*
Statement 8, *Supplementary Stewardship Reporting*
Statement 9, *Deferral of Implementation Date for SFFAS 4*
Statement 10, *Accounting for Internal Use Software*
Statement 11, *Amendments to Accounting for PP&E - Definitions*
Statement 12, *Recognition of Contingent Liabilities from Litigation*
Statement 13, *Deferral of Para.65.2-Material Rev.-Related Transactions*
Statement 14, *Amendments to Deferred Maintenance Reporting*
Statement 15, *Management's Discussion & Analysis*
Statement 16, *Amendments to Accounting for PP&E - Multi-Use Heritage Assets*
Statement 17, *Accounting for Social Insurance*
Statement 18, Amendments to Accounting Standards for Direct & Guaranteed Loans
Statement 19, *Technical Amendments to Accounting Standards for Direct & Guaranteed Loans*
Statement 20, *Elimination of Disclosures Related to Tax Revenue Transactions by the Internal Revenue Service, Customs and Others*
Statement 21, *Reporting Corrections of Errors and Changes in Accounting Principles*
Statement 22, *Change in Certain Requirements for Reconciling Obligations and Net Cost of Operations (amends SFFAS 7)*
Statement 23, *Eliminating the Category National Defense Property, Plant, and Equipment*

Statement 24, *Selected Standards For The Consolidated Report of the United States Government*

Statement 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*

Statement 26, *Presentation of Significant Assumptions for the Statement of Social Insurance: Amending SFFAS 25*

Statement 27, *Identifying and Reporting Earmarked Funds*

Statement 28, *Deferral of the Effective Date of Reclassification of the Statement of Social Insurance: Amending SFFAS 25 and 26*

Statement 29, *Heritage Assets and Stewardship Land*

Statement 30, *Inter-Entity Cost Implementation: Amending SFFAS 4*