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GOVERNMENT FINANCIAL REPORTING STANDARDS AND PRACTICES

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Government financial reporting makes public the data collected and accumulated in the government accounting system discussed in the previous chapter. This chapter is primarily concerned with the financial reports, particularly year-end financial statements, produced with data in a government's *ex post* financial accounting system. It will also deal with the reports for monitoring budget execution, and statistical reports for national and international macro-fiscal comparisons, and compare these three reporting systems. It is intended to be useful both to general readers and to practitioners who are responsible for: (a) determining the structure and content of financial reports; (b) approving the accounting policies used to prepare financial statements; (c) explaining the financial reports to legislators and the public; (d) dealing with auditors to resolve disputes; and (e) ensuring the proper use of information in financial reports in the government's decision-making processes.

After discussing some basic principles and concepts, the chapter will feature many examples of financial reporting. These illustrations are grouped in terms of basic financial statements for the whole of government, disclosures in year-end financial reports, budget-related reporting, reporting for components of a government, and reports compiled from finance statistics. The chapter will conclude with a series of recommendations for improving financial reporting standards and practices.

An Overview of Government Financial Reporting

This overview will present a set of basic principles of government financial reporting, discuss the trend in emphasizing financial reporting in accounting standards, the concept of general purpose financial statements, and the objectives of financial reporting.

Basic Principles

Reflecting their political culture, governments around the world vary in their fiscal transparency. While the government financial reporting practices in the Anglo-American tradition have become the benchmark against which national practices are measured, Western democracies share the following basic principles:

1. **Credibility.** Government financial reports should be trustworthy by presenting objective and reliable information in accordance to standards set by a body with a high degree of independence.

2. **Fair Presentation.** Even though total disclosure is impossible and unnecessary, governments should accurately and adequately disclose their financial conditions and performance.

3**. Value Added**. Government financial reports should add value relative to the government's already disclosed budgets and other fiscal information. Constrained by their historical orientation and unavoidable time lag, the special value of year-end financial reports lies in providing a long-term and overall perspective.

4. **Consistency and Uniformity.** The same measurement rules should be used over time unless circumstances change, and the same reporting formats should be used whenever possible, so as

to increase the understandability and comparability of financial reports. Furthermore, financial, budgetary and statistical reporting rules should be harmonized when possible, aligned when necessary, or otherwise reconciled.

5. **Annual Financial Statements**. At year-end governments should issue three basic financial statements based on its accounts: a statement of financial position in terms of assets, liabilities, net assets; a statement of financial performance in terms of revenues and expenses, and gains and losses; and a statement of cash flows classified in terms of operating, investing and financing activities. These general purpose financial statements (GPFS) provide common knowledge to all the stakeholders of the government.[i]

6. **Financial Disclosures**. Due to the limitations imposed by accounting recognition criteria and measurement techniques (discussed in previous chapter), general purpose financial statements should be complemented by additional financial data to achieve the goals of accountability and transparency.

7. **Reporting Entity**. General purpose financial statements should cover the government as a whole, including the primary government (controlling entity) and the other controlled entities for which the primary government is financially accountable.[ii] The fiscal relationships among these entities should be clarified, especially when the inter-relationships are not visible on the face of aggregative financial statements. Additional reports should be prepared and made available for the components of a government, such as departments and funds, to facilitate management and oversight.

8. **Full Reporting Capacity.** A government's financial information system should be capable of generating data for assessing budget execution, interim and year-end financial reports, as well as statistical reports and others required by laws and regulations.

9. **Budgetary Reporting**. For any fiscal year, a government should report, at the appropriate time and level of aggregation: initial and revised budgets and other financial plans; results of budget execution, including revenue collection and spending; and explaining financial results measured with different methods.

10. **Statistical reporting**. Government financial data and reports should serve as the foundation of government finance statistics compiled by national and international statistical offices, in order to facilitate international comparable evaluations of economic impacts and fiscal soundness of governments.

From Accounting to Reporting

The above principles are embodied in reporting standards and practices discussed throughout this chapter. As the previous chapter explained, general purpose financial statements of the reporting entity (identified in Principles 5 and 7 above) are the products of a systematic process of:

- *Identification* of transactions and events whose consequences would be analyzed in terms of their effects on the entity's economic resources and obligations;
- *Recognition* of some economic resources as assets and some obligations as liabilities, as well as subsequent changes on revenues and expenses, gains and losses;
- *Measurement* of the stock and flow measures mentioned above; and
- *Reporting* of the resulting measurements of recognized items in the financial

statements, and unrecognized items in financial disclosures.

During the past four decades, accounting standards and policies have shifted from providing guidance on identification, recognition and measurement to the specification of the form and contents of financial statements and reports.[iii] In the private sector, International Accounting Standards have become International Financial Reporting Standards (IFRS). Similarly, International Public Sector Accounting Standards (IPSASs) are actually accounting *and* financial reporting standards, and the same pattern has happened with the standards produced by the American Federal Accounting Standards Advisory Board (FASAB) and Governmental Accounting Standards Board (GASB); see Box 1).

Box 1. Contents of Financial Reporting Standards

General Principles [Details omitted]

Financial Reporting
- Defining the financial reporting entity
- Comprehensive Annual Financial Report
- Additional financial reporting considerations
- Notes to financial statements
- Budgetary reporting
- Cash flows statements
- Segment information
- Reporting entity and component unit presentation and disclosures
- Supplemental and special purpose reporting
- Statistical Section
- Interim financial reporting

Specific Balance Sheet and Operating Statement Items [over 30 topics; details omitted]

Stand-alone reporting – specialized units and activities [details omitted]

Source: Adapted from annual (2011) *Codification of Governmental and Financial Reporting Standards* published by the GASB.

General Purpose Financial Statements

In the English-language literature, unless otherwise specified, “financial reporting standards”, generally refer to the rules to be observed in preparing general purpose financial statements (GPFS). In the private sector, these financial statements are intended for investors and creditors, in contrast to “special purpose financial reports,” which are internal reports to management and external reports required by tax and regulatory authorities. The concept of GPFS was borrowed by state and local governments in the 1970s and by the federal government in the 1990s in the United States to establish a separate domain for setting standards for *external* financial reporting, to avoid infringing upon the prerogatives of legal authorities. This governance model has been elevated to the international level with the IPSAS Board (see previous chapter for details).

The concept of GPFS is new to governments in many countries, particularly where the primary object of financial reporting is the results of budget execution. In these countries, during the fiscal year and at year-end, actual revenues and expenditures are reported, either alone or in comparison to projected revenues and appropriations, respectively. These comparisons are used during the year to improve performance or reset fiscal targets. At the end of a fiscal year, they could also be used to explain why the actual deficit was different from the annual budgeted deficit. (In contrast, since a company’s budget is proprietary information, such “actual to budget” comparisons are not part of the business external financial reporting model.) Therefore financial reporting is not universally understood as only year-end reporting to the public. For example, China has pursued its own path to establishing a framework of accounting and financial reporting (Box 2).

Box 2. The Development of Government Financial Reporting Practice in China

By Western standards, Chinese government financial reporting is less than satisfactory. No government units have issued consolidated financial statements. There are no generally accepted accounting principles (GAAP) for governments. The Accounting Standards Committee is part of the Ministry of Finance, and the sub- committee on government and nonprofit organizations has been dormant. The supreme audit institution reports to the prime minister. Indeed, there is no government accounting as such; officially it is budget accounting. Yet, considering that government financial data were still regarded as state secrets as recently as 30 years ago, China has come a long way.

The Chinese minister of finance and his provincial and local counterparts annually present budget messages for the budget year and the final accounts for the past year to the people's congresses. Now, the government is required to publish the national budget, covering the central government and the local government sector within 15 days of approval. The number of departments submitting detailed budgets to the National People's Congress for examination increased from four in fiscal year 1999 to 98 in fiscal year 2010. In 2011, all these departments have also posted their approved budgets on-line. Many also post their budget execution reports as well. Similar moves are made at the provincial and local levels, although the record there is uneven. In response to public outcry (especially from vocal "netizens" or citizens on the Internet) about official corruption, the National Audit Office releases the results of its investigations into the misuse of public funds, creating annual "audit storms". The latest in the campaign for government fiscal openness under the 2007 "Open Government Information Regulations" is the on-line reporting of three types of government expenditures most susceptible to abuse, called "*san gong*" or "three official [expenditures]" for official overseas travel, official cars, and official receptions.

China still has a long way to go in producing Western-style financial reports. There are many theoretical and practical obstacles in producing the beginning balances of assets and liabilities for a whole-of-government balance sheet. In the evolving market economy, the government's property rights and financial responsibilities are unclear. For example, there are disputes over whether and how much local governments are liable for debts issued by their financial conduits, and little information on these debts is released..

Sources: The authors and Yunxiao Xu (2011), "China's Progress in Budgetary Transparency and Financial Reporting" unpublished working paper (Department of Public Finance, School of Economics, Peking University).

Objective of Financial Reporting

Whereas the primary purpose of budgetary reporting is to monitor budget execution and that of statistical reporting is to make international comparable fiscal analysis, year-end financial reports are the primary source of information needed to assess the reporting government's ability to fulfill its obligations to various stakeholders. These stakeholders' rights to know and need to know are the basis of their legitimate demand for the government's financial information. Their information demand has become the basis of the objectives of government and accounting financial reporting, which according to Drebin, Chan and Ferguson (1981, p. 107) are

> To provide (1) financial information useful for making economic, political and social decisions, and demonstrating accountability and stewardship, and (2) information useful for evaluating managerial and organizational performance.

This statement is elaborated by the American GASB (see Box 3) soon after it was established in 1984 to guide its standard setting activities.

Box 3. Objectives of Government Financial Reporting Per the American GASB

Financial reporting should assist in fulfilling government's duty to be publicly accountable and should enable users to assess that accountability.

a. Financial reporting should provide information to determine whether current-year revenues were sufficient to pay for current-year services.
b. 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.

c. Financial reporting should provide information to assist users in assessing the service efforts, costs, and accomplishments of the government entity.

Financial reporting should assist users in evaluating the operating results of the governmental entity for the year.

a. Financial reporting should provide information about sources and uses of financial resources.
b. Financial reporting should provide information about how the governmental entity financed its activities and met its cash requirements.
c. Financial reporting should provide information necessary to determine whether the entity's financial position improved or deteriorated as a result of the year's operations.

Financial reporting should assist users in assessing the level of services that can be provided by the governmental entity and its ability to meet its obligations as they become due.

a. Financial reporting should provide information about the financial position and condition of a governmental entity.
b. Financial reporting should provide information about a government 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.
c. Financial reporting should disclose legal or contractual restrictions on resources and the risks of potential loss of resources.

Source: GASB *Concepts Statement* No. 1 "Objectives of Financial Reporting" (abridged version, original text was italicized, paragraphs 77, 78 and 79; paragraph numbers were omitted in the above quotations). The statementwas issued in 1987 and amended in 2005.

Readers may consider the statements in Box 3 as a basis for assessing the usefulness of the illustrative financial statements in the rest of the chapter.[iv]

Basic Financial Statements

Three basic financial statements are at the core of an annual financial reports a statement that reports the entity's assets and liabilities – or financial position – at the beginning and the end of the fiscal year; a second statement that explains how the financial position improved or deteriorated during the year in terms of revenues and expenses, gains and losses; and a third statement that reports the entity's amounts of cash at the beginning and end of the year, and the activities which increased or decreased the level of cash during the year.[v]

Statement of Financial Position

The statement of financial position – also called a balance sheet (see Chart 1) – is a reminder that a government inherits both assets and liabilities from the past. Arranged in the order of nearness to cash, assets are preferably classified as: cash, current financial assets, non-current financial assets, and capital assets. Liabilities, mostly financial in nature, are conventionally classified in terms of maturity as current liabilities and non-current liabilities.[vi] Total assets minus total liabilities equal net assets or net worth.

Chart 1. Illustrative Statement of Financial Position

Public Sector Entity – Statement of Financial Position
As at December 31, 20x2
(in thousands of currency units)

ASSETS	**20x2**	**20x1**
Current assets	X	X
Cash and cash equivalents	X	X
Receivables	X	X
Inventories	X	X
Prepayments	X	X

Other current assets	X	X
	X	X
Non-current assets		
Receivables	X	X
Investments in associates	X	X
Other financial assets	X	X
Infrastructure, plant and equipment	X	X
Land and buildings	X	X
Intangible assets	X	X
Other non-financial assets	X	X
	X	X
Total assets	X	X
LIABILITIES		
Current liabilities		
Payables	X	X
Short-term borrowings	X	X
Current portion of long-term borrowings	X	X
Short-term provisions	X	X
Employee benefits	X	X
Superannuation	X	X
	X	X
Non-current liabilities		
Payables	X	X
Long-term borrowings	X	X
Long-term provisions	X	X
Employee benefits	X	X
Superannuation	X	X
	X	X
Total liabilities	X	X
Net assets	X	X

Source: Adapted from IPSAS No. 1 “Presentation of Financial Statements,” (p. 75 of IPSAS 2010 Edition). The original statement includes ownership interest in other entities as equity to be added to net assets.

The illustrated classification organizes financial data in accordance to their urgency and priority in financial management. It also identifies the sequential stages in the gradual transition to accrual accounting: the top priority is to collect data about cash, followed by data about current financial resources *and* current liabilities, then financial resources *and* all liabilities, and finally capital assets (Chan, 2003).

Statement of Financial Performance

The statement of financial performance (see Chart 2) reports revenues by source and expenses by function, organization unit or object (e.g. wages, interest). Its "bottom-line" shows whether the government's financial position improved or worsened during the reporting period. Financial performance is defined primarily by the net results of operations: revenues minus expenses = surplus or deficit. Under the accrual basis, revenues include accounts receivables for having provided services, and taxes receivable for claiming the taxes due. Expenses include costs deferred to the future for payment and the cost of using capital assets The accrual basis is consistent with the concept of inter-generational or inter-period fiscal equity, which argues that the cost of services (i.e. expenses) should be financed by its recipients (see Box 3).

Chart 2. Illustrative Statement of Performance

Public Sector Entity
Statement of Financial Performance
and Changes in Net Assets
For the Year Ended December 31, 20x2
(in thousands of currency units)

Revenues	**20x2**	**20x1**
Taxes	X	X
Fees, fines, penalties, and licenses	X	X
Revenues from exchange transactions	X	X
Transfers from other government entities	X	X
Other revenue	X	X
Total revenue	X	X
Expenses by Function	(X)	(X)
General public services	(X)	(X)
Defense	(X)	(X)
Public order and safety	(X)	(X)
Education	(X)	(X)
Health	(X)	(X)
Social protection	(X)	(X)
Housing and community amenities	(X)	(X)
Recreational, cultural, and religion	(X)	(X)
Economic affairs	(X)	(X)
Environmental protection	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
Total expenses	(X)	(X)
Surplus/(deficit) for the period	X	X

Net gains/(losses)[1]	X	X
Net Assets at December 31, 20x1[2]	X	X
Net Assets at December 31, 20x2	X	X

Notes:

[1] These changes correspond to the changes in net worth resulting from other economic flows, which are described in a separate statement in the IMF Government Finance Statistics (GFS).
[2] The beginning and ending balances of net assets/equity are added to show the relationship between financial position and financial performance. The title of the statement is modified to reflect the addition of the net assets/equity information. A separate statement of changes of net assets/equity could be prepared but is not illustrated.

Source: Adapted from IPSAS No. 1 "Presentation of Financial Statements," (pp. 76, 78, 79 of IPSAS 2010 Edition).

Statement of Cash Flows

The statement of cash flows (Chart 3) complements the accrual-based statement of performance and the balance sheet to make sure that liquidity is notoverlooked. For example, if a government provides services but does not collect taxes and fees from customers on a timely basis, while paying employees and suppliers in cash on time, this practice would contribute to both an accrued surplus *and* a cash deficit. The statement of cash flows explains the change of cash positions between the beginning and the end of the reporting period in terms of three types of activities: operations, financing and investing. Cash receipts and payments from operating activities produce cash operating surplus or deficit. The other two types of activity – financing and investment - provide insights into a government's borrowing and capital spending. For example, issuing $20 million in bonds and spending the same amount on capital equipment in a given period would result in adding $20 million in capital assets and in bonds payable on the balance sheet, with no effects on the operating surplus or deficit as measured on a cash or accrual basis. The cash flow statement would show these transactions as a net cash inflow of $20 million in financing activities, and a net cash outflow of $20 million ininvesting activities. (The illustrative budget and Statement of Receipts and Payments in Cash Basis IPSAS include debt proceeds in the total receipts and debt repayments in the total payments. Refer to the recommendations section for the authors' suggestion for change.)

Chart 3. Illustrative Cash Flow Statement

Public Sector Entity – Cash Flow Statement
For the Year Ended December 31, 20x2
(in thousands of currency units)

CASH FLOWS FROM OPERATING ACTIVITIES	**20x2**	**20x1**
Receipts		
Taxation		
Sales of goods and services	X	X
Grants	X	X
Interest received	X	X
Other receipts	X	X
Payments	X	X
Employee costs		
Superannuation	(X)	(X)
Suppliers	(X)	(X)
Interest paid	(X)	(X)
Other payments	(X)	(X)
Net cash flows from operating activities	X	X
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of plant and equipment	(X)	(X)
Proceeds from sale of plant and equipment	X	X
Proceeds from sale of investments	X	X
Purchase of foreign current securities	(X)	(X)
Net cash flows from investing activities	(X)	(X)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	X	X
Repayments of borrowings	(X)	(X)
Distribution/dividend to government	(X)	(X)
Net cash flows from financing activities	X	XX
Net increase/(decrease) in cash and cash equivalents	X	X
Cash and cash equivalents at beginning of period	X	X
Cash and cash equivalent at end of period	X	X

Source: Adapted from IPSAS No. 2 "Cash Flow Statements," (p. 100 of IPSAS 2010 Edition)

In summary, government financial reporting standards call for the presentation of accrual-based statements of financial position and financial performance, and a statement of cash flows. The application of accounting recognition criteria results in the exclusion of much useful information from these basic financial statements. Such information is reported in supplemental statements and disclosures.

Supplemental Statements and Disclosures

The three basic financial statements described above have three weaknesses: (a) they look different from and are much less timely than the information in the budget execution report, which shows a familiar bottom-line of cash deficit or surplus; (b) the reported liabilities omit some very significant obligations; and (c) the information is voluminous and could be difficult to understand. They are therefore supplemented by additional information that: explain the discrepancy between cash deficit and accrual deficit; reveal long-term government obligations not recognized as liabilities; and provide narrative and graphical presentations to enhance public understanding.

Reconciliation of Cash Deficit and Accrual Deficit

When a government reports its budget execution results on a cash basis and its financial performance on an accrual basis, the public may be confused. Since government budgets in many countries, including the U.S., are not subject to financial accounting rules, it is necessary to reconcile data on budget execution and financial performance by analyzing the sources of difference between the two sets of data. The annual financial reports of the U.S. Government have included such detailed technical reconciliation that a simpler document was also published to help the public understand the original analysis (Chart 4).

Essentially, due to its financial policy of deferring payment of many operating expenses to the future, the American Government's annual accrual deficits were consistently larger than cash deficits in most years. (The largest amounts are for non-cash benefits earned by civilian and military employees.) For example, in fiscal year 2008, the accrual deficit at $1,009 billion was more than twice the cash deficit of $455 billion. As Chan and Xu (2012) also note, the only recent exception to this pattern occurred in the recent financial crisis, when the U.S. Government borrowed and used so much cash to rescue failing banks and businesses that its fiscal year 2009 cash deficit at $1,417 billion was larger than the already unprecedented accrual deficit of $1,253 billion.[vii]

Chart 4. Reconciling Cash and Accrual Deficit Numbers

Crosswalk between Accrual and Cash Deficits
of the United States Government
For the Fiscal Years 2006 and 2007

	Dollars in billions	
	2006	**2007**
Accrual deficit (notes)	**-449.5**	**-275.5**
Components of accrual deficit not part of the cash deficit		
Change in liability for military employee benefits	74.9	60.3
Change in liability for veterans compensations	31.2	-26.1
Changes in liability for civilian employee benefits	81.3	55.9
Changes in environmental liabilities	45.4	36.8
Depreciation expense	82.9	45.3
Changes in insurance liabilities	-20.4	-1.9
Increase in accounts and taxes receivable	-2.7	-19.0
Other	25.5	46.0
Total	**318.0**	**197.3**
Components of cash deficit not part of the accrual deficit		
Outlays for capitalized fixed assets	-103.7	-58.8
Other	-11.7	-10.7
Total	**-114.8**	**-69.5**
Net amount of all other reconciling differences	-1.5	-15.1
Cash deficit (notes)	**-247.7**	**-162.8**

Notes:

[1] This reconciliation schedule is published annually in the official U.S. Government annual financial reports. This simplified version is the most recent available version.
[2] Some important aspects of the reconciliation are not showcased in this example, such as in-kind transfers made by government, and increases in assets resulting from a claim on an external party.
[3] The accrual deficit is called “net operating cost” in the GAO’s condensed statement and the original financial statement. The *actual* cash deficit was mistakenly called “cash budget deficit” in the GAO’s condensed statement and “unified budget deficit” in the original financial statement. The concept of “unified budget” was proposed in the Report of the President’s Commission on Budget Concepts in 1967 in order to have one single budget that would best describe the entire Federal government’s impact on the economy.

Source: Government Accountability Office (2008), “Understanding Similarities and Differences between Accrual and Cash Deficits, Updated for Fiscal Year 2007”.

Reporting Social Benefits Commitments and Fiscal Sustainability

Compared with debts to bondholders and employees, public policy commitments to provide a social safety net pose thorny recognition and measurement issues in government accounting and financial reporting. Often enshrined in laws to give public pensions, welfare payments and services, these policies provide benefits commonly on the basis of eligibility. Whether these promises represent a liability of the government is a debatable issue. In the U.S. Government these programs are accounted for in separate “trust funds” (i.e. special revenue funds), which issue their own annual reports. Their inclusion in the government-wide financial statements would require their recognition as liabilities, a step that accounting policy makers have declined to take. Furthermore, the large amounts of unfunded benefits threaten the long-term sustainability of these programs as well as public finances in general. The actuarial measurement of the benefits for eligible demographic groups – estimates of future payments and revenues projected over 75 years and discounted to the reporting period – is very different from the conventional accounting methods of measuring the consequences of past transactions and events.

These fiscal “time bombs” are too important to be relegated to supplemental financial disclosures and yet too controversial to be reported in the audited financial statements. A compromise solution in the U.S. was to prepare a Statement of Social Insurance (Chart 5) that combines data from the fund reports. As befitting the ambiguous status of these programs, this statement is placed behind the primary financial statements but ahead of the hundreds of pages of other financial disclosures. The contents of the statement in Chart 5 are consistent with the provisions of FASAB Statement No. 36 on "Comprehensive Long-term Projections for the U.S. Government," which, however, requires the present values be expressed as percentages as the Gross Domestic Product (FASAB, 2009).

Chart 5. Statement of Social Insurance
(Excerpted and Annotated)

United States Government
Statement of Social Insurance
Present Value of Long-Range (75 Years …) Actuarial Projections
(in billions of dollars)

	2010[1]
Federal Old-age, Survivors and Disability Insurance (Social Security)	
[Cash] Revenue from all current and future participants[2]	40,118
[Cash] Expenditures for scheduled future benefits for all current and future participants	48,065
Present value of future expenditures in excess of future revenues	(7,947)
Medicare [for the elderly]	
Federal Hospital Insurance	(2,683)
Federal Supplementary Medical Insurance	(12,901)
Federal Supplementary Medical Insurance	(7,229)
Present value of future expenditures in excess of future revenues	(22,813)
Railroad Retirement	(103)
Black Lung	6
Total present value of future expenditures in excess of future revenues	(30,857)

[1] This is year in which the projections were made and present values calculated. The statement has additional columns for projections made in 2009, 2008, 2007, and 2006.
[2] The statement shows separate projections for participants who have attained eligibility age (65 and over), not attained eligibility age and future participants, for both revenue and expenditures. Similar details appear for the other social insurance programs.

Management Discussion and Analysis (MD&A)

The three basic financial statements may be too complex and loaded with numbers for easy comprehension by many readers. In some countries, the government is required to explain them, as well as the government's overall financial position, in the management discussion and analysis (MD&A) section of a financial report. The American GASB, for example, requires the MD&A to be placed ahead of financial statements to:

- Briefly describe the financial statements and provide condensed financial information;
- Analyze the government's overall financial position and performance, and that of the individual funds;
- Explain the significant variances between the budget and actual results, and capital and debt activities;
- Disclose facts that are likely to affect the government's finances (GASB, 2009, p. 183).

In summary, as government financial statements become more complex, readers need help to understand them. This help comes in the form of management discussion and analysis (MD&A) as well as an explanation of how accrual deficits are reconciled with cash deficits. Furthermore, the non-recognition of welfare benefit (and other long-term) commitments as liabilities is partially compensated by a separate statement that provides early warnings about the unsustainability of these programs.

Budget-related Reporting

The neglect of the budget in the basic financial statements is remedied in three ways: (a) interim and annual reporting of budget execution, (b) making budget-to-actual comparisons according to budget measurement rules, and (c) providing explanation of the effects of different methods used in budgeting and accounting.

Ex Post Budget Reporting

Budget systems usually have reporting requirements. As Lienert and Fainboim (2010) point out, in addition to annual reporting, midyear, quarterly and even monthly reports are needed to provide timely feedback about budget execution. The reporting entity in these reports is usually a budget unit, which could be a budget account, a fund, a department or a government (see Charts 6 and 7 for generic illustrations).

Chart 6. A Simplified Revenue Ledger Budget Unit

	Projected Amount	Collected Amount	Uncollected Amount
1. Initial projection	$1,000,000		$1,000,000
2.Actual collection, 1st month		$100,000	$900,000
3. Revision of projection	-$50,000		$850,000

Notes:
[1] The city council approved the collection of $1,000,000 of a tax for a fiscal year.
[2] After collecting $100,000 during the first month.
[3] Later the city council authorized a downward revision of revenue estimate by $50,000.

Chart 7. A Simplified Expenditure Ledger Budget Unit

	Appropriation	Use of Appropriation	Available Balance
1 Initial Amount	$100,000		$100,000
2 Cash outlay		$20,000	80,000
3 Encumbrance		40,000	40,000
4 Cost increase		3,000	37,000
5 Supplemental Appropriation	10,000		47,000

Notes:
[1] The city council approved $100,000 for a certain program.
[2] $20,000 was paid for equipment and supplies.
[3] A contract for services with estimated cost was signed.
[4] After services were provided, the government received and approved a bill of actual cost of $43,000 for payment.
[5] The city council approved an additional $10,000 for the program.

Since traditional government budgets are mostly concerned about spending and related revenues, ex post budget reports share a similar orientation. It may be instructive to compare this kind of budget reporting with accounts-based financial reporting (see Box 4).

Box 4. Comparing Budget Reporting and Financial Reporting	
Budget Reporting	Financial Reporting
• Regulated by budget laws and rules of a jurisdiction. • Interim reporting during the fiscal year. • Reviewed and approved by high-level executives and legislature. • Focusing on revenues and expenditures in most countries. • Rarely includes account-based financial statements.	• Regulated by GAAP accepted nation-wide and with emerging international consensus. • Takes place after end of fiscal year. • Often audited by government or private-sector auditors. • Covers all aspects of public finances, including assets and liabilities. • Often includes comparison between the budget and actual results.

Budget to Actual Comparison

Year-end budget-to-actual comparisons usually use budget measurement rules. Such comparisons primarily serve evaluation and accountability purposes. The illustrative budget comparison in Chart 8 has several noteworthy features. First, there are only the flow measures of revenues and expenditures. Since the budget is on the cash basis, in the interest of comparability, the actual amounts are also on the cash basis. Second, both the original and final budgets are included so that it is possible to see budget adjustments in response to unanticipated circumstances during the year. The final budget is the benchmark again which actual performance is compared. Finally, there is no information about beginning and ending balances of either receivables or payables. The last point highlights the differences between the cash basis commonly used in reporting on the budget, and the accrual basis recommended for financial accounting and reporting.

Chart 8. Budget Comparison Statement of Comparison of Budget and Actual Amounts For Government XX for the Year Ended December 31, 20XX Budget on Cash Basis				
(in currency units)	**Budgeted Amounts**		**Actual Amounts on Cash Basis**	*Difference between Final Budget and Actual*
	Original	**Final**		
RECEIPTS				
Taxation	X	X	X	X
Aid Agreements	X	X	X	X
International agencies	X	X	X	X
Other Grants and Aid	X	X	X	X
Proceeds: Borrowing	X	X	X	X
Proceeds: Disposal of plant and equipment	X	X	X	X
Trading Activities	X	X	X	X
Other receipts	X	X	X	X
Total receipts	X	X	X	X
PAYMENTS				
Health	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)
Public order/safety	(X)	(X)	(X)	(X)
Social Protection	(X)	(X)	(X)	(X)
Defense	(X)	(X)	(X)	(X)
Housing and community amenities	(X)	(X)	(X)	(X)
Recreation, culture and religion	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)
Other	(X)	(X)	(X)	(X)
Total payments	(X)	(X)	(X)	(X)
NET RECEIPTS/(PAYMENTS)	**X**	**X**	**X**	**X**

Source: IPSAS Statement No. 24 "Presentation of Budget Information in Financial Statements," (p. 757 of IPSAS 2010 Edition).

Effects of Budgetary and Accounting Bases

When budgeting and accounting use different measurement methods, the differences and effects on the reported numbers should be identified. As the City of Chicago example in Chart 9 shows, the city's General Fund had a balanced budget using measurement methods apparently allowed by law. However, when judged by accounting rules, a deficit of $232 million (or approximately 7 percent of total expenditures) appeared. Most of the discrepancy is due to the overstatement of revenues, including counting $164 million of debt proceeds as revenue. This reconciliation therefore could also be viewed as an accounting critique of budgeting methods.

Chart 9. Reconciling the Accounting and Budgetary Basis

City of Chicago General Fund
For the 2008 fiscal year
Amounts in millions of dollars

	Amount
Revenue, GAAP Basis	$2,875
Add:	
Proceeds of debt	164
Transfers in	94
Prior year's surplus utilized	1
Revenue, Budgetary Basis	$3,135 =====
Expenditures, GAAP Basis	$3,107
Add:	
Transfers out	25
Encumbrances in 2008	28
Deduct:	
Payments on prior years' encumbrances	(17)
Provision for doubtful accounts	(8)
Expenditures, Budgetary Basis	$3,135 =====

Source: City of Chicago, Comprehensive Annual Financial Report, 2008, p. 56.

When a budget includes a projection of the government's financial position at the end of the fiscal year, it is possible to compare the budget and the government's actual financial position. This method is used by the Government of New Zealand, where budgets are in effect projected financial statements. Chart 10 displays a schematic presentation of both documents.

Chart 10. Budget Comparison When the Budget Covers Both Stocks and Flows

Schematic Presentation of the Financial Reports of
The Government of New Zealand

Forecast 30 June 2011		**Financial Statements**	**Actual**	
Budget 2010	**Budget 2011**		**30 June 2011**	**30 June 2010**

Statement of Financial Performance				
XXX	XXX	Revenues	XXX	XXX
XXX	XXX	Expenses	XXX	XXX
XX	XX	Operating Balance	XX	XX
X	X	Revaluations	X	X
XX	X	Comprehensive Income	X	X
Statement of Cash Flows				
XXX	XXX	From operations	XXX	XXX
XXX	XXX	From investing activities	XXX	XXX
XXX	XXX	From financing activities	XXX	XXX
Statement of Net Worth				
XX	XX	Net Worth	XX	XX
Statement of Financial Position				
XXX	XXX	Assets	XXX	XXX
XXX	XXX	Liabilities	XXX	XXX
XX	XX	Net Worth	XX	XX

Source: Audited Financial Statements of the Government of New Zealand, 2011.

In summary, the examples in this section show that financial reporting provides feedback on budget execution, and accounting concepts are used to critique budgeting practices.

Component Reporting

The preparation of accrual-based financial statements for the whole government is a relatively recent phenomenon in the last 30 years, while reports on budget execution and reports for components of governments remain the norm (see Charts 6 and 7 above). Components of a government include legally independent entities, such as government business enterprises, as well as departments and off-budget funds. The latter are entities for which accounting records are kept, but national practices differ with regard to the preparation and publication of their financial statements.

Department Financial Statements

Publishing departmental general purpose financial statements is an exception rather than the rule internationally. Departmental resource accounts (DRAs) in the U.K. and departmental consolidated financial statements (CFSs) in the American federal government are notable examples. The British accrual-based DRAs are used to request Parliamentary appropriations (“grants”). American federal departmental CFSs, on the other hand, are intended to enhance administrative accountability and have served as crucial building blocks for the government-level CFSs. The CFSs at the two levels differ in several respects:

- In departmental CFSs, the effects of inter-departmental transactions are reported separately from those with non-federal entities.
- Departments consider appropriations received from Congress as assets, and distinguish budgetary financing from financing from actual transactions. Departmental statements on budgetary resources have no counterpart as the government level.
- Departments that administer activities (e.g. the Treasury collects taxes) on behalf of the government prepare a statement of custodial activities.
- The departmental CFSs are accompanied by many non-financial performance measures in an annual Accountability and Performance Report.

Fund Financial Statements

When a government budgets and controls its financial operations through a series of funds – pools of resources for specified purposes – fund financial statements are prepared for management and oversight purposes. In American state and local governments, these statements are also regarded as indispensable parts of a Comprehensive Annual Financial Reports (CAFRs), complementing the government-wide financial statements. As even a small government might have many funds, funds are classified into several fund types (e.g. capital project funds) and then fund groups (e.g. governmental funds and enterprise funds). This makes it possible to have increasingly aggregative financial statements that form a "reporting pyramid." In this structure, funds are combined, with inter-fund transactions being identified but no eliminated, in the reporting process. In comparison with government-level reporting, in fund reporting:

- There are budget comparisons (see Chart 8) for funds with legislatively adopted budgets.
- Debt proceeds, giving rise to liabilities at the government level, are regarded as a fund's financing source other than revenues, thus increasing fund balance.
- Inter-fund transfers in and out of a fund are regarded as other financing sources and uses, respective, also affecting fund balance.

In summary, financial reports for components of government can serve useful financial management and oversight purposes. However, they may be of secondary concern to the public.

Statistical Reporting

In addition to preparing financial reports, a government's accounting system supplies data for the compilation of Government Finance Statistics (GFS) and the System of National Accounts (SNA). Chart 11 identifies the four financial statements prepared with GFS, along the core balances (set in bold) and other key variables. Since the 2001 edition of the IMF's *GFS Manual* requires accrual accounting and aggregative financial statements. The update of the System of National Accounts 2008 provide further opportunities, and the prospects for harmonization have improved.[viii]

However, many types of reconciliation are required at the technical level because accountants and statisticians have different objectives, which may require different interpretations to the same general concepts (see Box 5).

Chart 11. Financial Statements Required by the GFS Manual 2001

No.	Financial Statements and Balances
Statement of Government Operations	
1	Revenue
2	Expense
	Net operating balance (1-2)
31	Net acquisition of nonfinancial assets
	Net lending/borrowing (1-2-31 = 32-33)
32	Net acquisition of financial assets
33	Net incurrence of liabilities
Statement of Economic Flows	
4,5	Change in net worth resulting from other economic flows (41+42-43 + 51+52-53)
41,51	Change in nonfinancial assets
42,52	Change in financial assets
43,53	Change in liabilities
Balance Sheet	
6	Net worth (61+62-63)
61	Nonfinancial assets
62	Financial assets
63	Liabilities
Statement of Sources and Uses of Cash	
1 2	Cash receipts from operating activities Cash payments from operating activities
	Net cash inflow from operating activities (1-2)
31	Net cash outflow from investments in nonfinancial assets
	Cash surplus/deficit (1-2-31)
32x	Net acquisition of financial assets other than cash
33	Net incurrence of liabilities
	Net cash inflow from financing activities (-32x+33)
	Net change in the stock of cash (1-2-31-32x+33=3212+3222), where 3212 refers to domestic currency and deposits and 3222 refers to foreign currency and deposits

Source: IMF *Governance Finance Statistics Yearbook* 2010, Annex I. Highlights of the GFSM 21001 Framework. The four financial statements are presented separately in the Yearbook.

Box 5. Financial Reporting and Statistical Reporting

Similarities

- Common goal to portray economic realities in a useful, valid and accurate manner.
- Measurement in terms of monetary units and on an accrual basis.

• Measuring economic activities affecting financial conditions. • Measuring stocks and flows.		
Differences		
	Financial Reporting	Statistical Reporting
Primary Purpose	Aiding decision making and enforcement of accountability.	Analysis and assessment of macro-fiscal policies.
Rules and Enforcement	National rules and international advisory rules by government or professional bodies; covering only entities in jurisdiction; no international enforcement mechanism.	Statistical guidelines in SNA and GFS by experts from an international consortium of official bodies; covering whole economy; enforced through treaty and membership obligation to international governmental bodies.
Perspective, Reporting Entity	Micro perspective; basic accounting entity is an account; scope of reporting entity depends on purpose and control; can range from an account to entire public sector; common reporting entity is the primary government (controlling unit) and its controlled entities.	Macro perspective; basic accounting entity is institutional unit; scope of reporting entity depends on principal functions, behaviors, and objectives; sector is the basic reporting entity: general government, nonfinancial corporations, financial corporations, nonprofit institutions, and households. Depending on purpose of analysis, sectors may be combined or subdivided.
Major Financial Statements	Financial information is presented in a balance sheet, a statement of financial performance, a cash flow statement, and possibly a statement of change of financial position.	Statistical information is presented in a balance sheet, a statement of sources and uses of cash; statement of government operations, and statement of other economic flows.
Valuation Basis	A mix of historical cost and economic value; economic value is controversial.	All variables in principle measured by their economic value, a common preference among economic statisticians.
Estimation	Increasingly common practice but reluctantly accepted.	A common practice taken for granted.
Quality Criteria[1]	Relevance, reliability, comparability, and understandability.	Assurances of integrity, methodological soundness, accuracy and reliability, serviceability, accessibility, and comparability.

[1] While materiality or a threshold level is considered in deciding the inclusion of an information item in a financial statement, statistical reporting, in the interest of international comparability, requires all items be presented in a standardized structure regardless of its materiality.

Source: Authors' synthesis; Lalibertie (2004), GFSM (2001), correspondence with Sage de Clerck.

In order to enhance the usefulness of whole-of-government financial statements for fiscal analysis, some governments, such as in Australia, supplement them with disclosures at the general government sector level (see Chart 12).

Chart 12. General Government Sector and Whole Government

Statement of Financial Performance
for the General Government Sector

For Year Ended December 31, 20x2 (in thousands of currency units)				
	GGS	**PFC and PNFC**	**Elimination**	**Total W-of-G**
Revenue				
Taxes	X		(X)	X
Fees, fines, penalties	X	X	(X)	X
Revenue from other sectors	X	X	(X)	
Transfers from other governments	X	X		X
Other operating revenue	X	X	(X)	X
Total revenue	X	X	(X)	X
Expenses				
General public services	X			X
Defense	X			X
Public order and safety	X	X		X
Economic affairs	X			X
Environmental protection	X	X	(X)	X
Housing and community amenities	X	X	(X)	X
Health	X	X		X
Recreational, cultural, and religious	X			X
Education	X	X	(X)	X
Social protection	X	X	(X)	X
Total expenses	X	X	(X)	X
Surplus/(deficit)	X	X	(X)	X

Abbreviations: GGS = General Government Sector, PFC = Public Financial Corporations; PNFC = Public Non-financial Corporations; W-of-G = Whole of Government

Source: Adapted from IPSAS No. 22 “Disclosure of Financial Information about the General Government Sector,” (p. 673, 2010 edition of IPSA). The original illustration has another column for 20x1.

Probably the U.K. Government has made the most effort in aligning financial reporting with statistical reporting. According to the explanation accompanying the release of the 2010 consolidated financial statements, called Whole-of-Government Accounts (WGA, see Chart 13), the WGA “is a consolidated set of financial statements for the UK public sector. It consolidates the audited accounts of around 1,500 organisations across the public sector, including central government departments, local authorities, devolved administrations, the health service, and public corporations.” This first-time audited WGA, released 19 months after the end of the fiscal year, is based on EU adopted International Financial Reporting Standards (IFRS) adapted or interpreted for the public sector context,

Chart 13. Financial Statements for Entire Public Sector United Kingdom Government Summary Whole-of-Government Accounts Prepared on an unaudited consolidated basis In billions of pounds	
Summarized Statement of Revenue and Expenditures For the year ended 31 March 2010	Amount
Revenue	
Taxation revenue	(488.4)
Other revenue	(97.1)
Total operating revenue	(585.5)
Expenditure	
Social benefit payments	195.6
Staff costs	180.4
Other expenditure	292.7
Total operating expenditure	668.7
Net financing cost and gains and losses on assets	80.9
Net deficit for the year	164.1
Summarized Statement of Financial Position As at 31 March 2010	
Assets	
Property, plant and equipment	708.0
Equity investment in public sector banks	65.3
Other assets	432.0
Total assets	1,205.3 ======
Liabilities	
Net public service pension liability	(1,133.3)
Gilt edged securities	(803.8)
Provisions	(105.0)
Other liabilities	(379.4)
Total liabilities	(2,421.5) =======
Net liabilities	(1,216.2)
Financed by future revenues:	
General reserves	1,421.4
Revaluation reserve	(205.2)
Liabilities to be funded by future revenues	1,216.2 ======

Note: The full audited Whole-of-Government Accounts, 2010, became available on 29th November 2011.

Source: UK Government Unaudited Summary Whole-of-Government Accounts, 2010, available on 13th July, 2011.

In summary, even though financial reporting and statistical reporting serve distinctive purposes, they are complementary and their harmonization would increase the efficiency and effectiveness of government accounting systems.

Conclusion

This chapter has discussed budgetary reporting, financial reporting and statistical reporting in government. Budgetary reporting systems produce interim and annual budget execution and comparison reports. Financial reporting systems produce year-end general purpose financial statements and other disclosures. Statistical reporting systems produce reports compiled with government finance statistics. Thus in a broader sense, financial reporting engages accountants, budget preparers and analysts, as well as economic statisticians. These three professional groups contribute their distinctive theoretical perspectives and have their own institutional mechanisms for providing technical guidance. The interplay between these complementary and possibly competitive groups and institutions highlight the limitations and issues of any single angle of presenting government finances.

Budget reporting systems are regulated by laws and regulations of individual jurisdictions, which are enforced legally.[ix] Financial reporting systems are regulated by mandatory or advisory standards, which are recognized in Anglo-American countries as Generally Accepted Accounting Principles/Practices (GAAP). Compliance is enforced by financial audits performed by government auditors or licensed private-sector auditors. Statistical reporting systems are regulated by recommended international guidelines (i.e. IMF GFSM 2001) and regional guidelines (e.g. EuroStat for EU countries), which are enforced by monitoring and voluntary compliance.

For the past three decades, the form and contents of year-end financial statements (and financial reports of which they are the core) have increasingly become the subject of provisions of financial accounting standards, so much so that these standards are in effect accounting *and* financial reporting standards or ultimately reporting standards. An advantage of this shift is that the outputs of the long and complex accounting process are clearly identified and often specified in considerable detail. A disadvantage of this output-oriented approach is that many governments outside of the Anglo-American tradition lack the financial accounting infrastructure – double-entry bookkeeping and an accountant profession trained to operate such a system – to develop the blueprints to implement standards of a general and conceptual nature.

The whole-of-government financial statements featured in this chapter are the latest products of sophisticated financial accounting and reporting systems traceable to advanced Anglo-American countries. These countries have spent a substantial amount of resources over several decades in research and development activities. Even so, the results are not uniformly satisfactory; for example, auditors in France and the UK have qualified their opinions and American federal auditors have declined to express an audit opinion. It is likely that governments of low-income countries in the developing world will have to overcome weaknesses in financial management before it is possible to produce reliable numbers.

Budgetary reports are used in and useful for monitoring spending behavior within established financial management structure of a particular government. Statistical reports use established institutional structures and are useful for making international comparisons of fiscal condition and performance. There is little empirical evidence that year-end financial statements are used by the identified user groups for making decisions and enforcing fiscal accountability.

Recommendations

Whereas the previous sections presented authoritative standards and official policies, we end the chapter with our recommendations for improving government financial reporting.

Change IPSAS on Financial Reporting Under the Cash Basis. Standing in contrast to the over thirty accrual-basis IPSAS is the lone standard called Financial Reporting Under the Cash Basis, intended for governments in developing countries not ready for accrual accounting. The standard requires the preparation of a consolidated statement of cash receipts and payments (see the middle column of Chart 14). The authors recommend an alternative format for presenting cash flow information in order to distinguish borrowed cash from other sources of cash (see the right column of Chart 14). They believe that proceeds from borrowing and repayments of borrowings are qualitatively different from other receipts and payments, and should be listed below the line of net change. This treatment is particularly important because debt proceeds are sometimes improperly used to balance a cash budget; see the example in Chart 9 and the illustration in Appendix 1A in the cash-basis IPSAs. We would further recommend that the cash information be presented in the format of the cash flow statement (see Chart 3), and this standard be modified to serve as a preparatory step toward accrual accounting and financial reporting.[x]

Chart 14. Alternative Presentation of Cash Information

	Format Per Cash Basis IPSAS	Recommended Format
Cash Inflows		
Receipts other than borrowing	X	X
Proceed from borrowings	X	
Total receipts	**X**	X
Cash Outflows		
Payments other than loan repayment	(X)	(X)
Repayment of borrowings		
Total payments	(X)	
	X	(X)
Increase/(Decrease) in cash	X	
Increase/(Decrease) in cash other than debt proceeds and repayment		X

Proceeds from borrowings Repayment of borrowings		X (X)
Increase/(Decrease) in cash		X

Sources: The left and middle columns are abbreviation from the illustrated statement in Appendix 1A of the Cash Basis IPSAs (IPSAS Board, 2010). Right column represents the authors' recommendation.

Transition to Accrual Accounting and Financial Reporting. As the determination of the initial balances of assets and liabilities will require much resources and time, the following financial statements should be prepared to record the recognized effects of transactions and events of the periods after transition to accruals began:

1. Budget execution report and budget comparisons on an interim and annual basis
2. Statement of cash flows and cash balances
3. Statement of revenues and expenses, and gains and losses

Building on a robust cash accounting and reliable cash reporting, it is recommended that governments take the next step to construct a complete chart of accounts, and adopt or develop the standards discussed in the previous chapter to recognize and measure assets and liabilities in the following sequence toward the construction of a complete balance sheet:

1. Current financial resources and current liabilities
2. Add long-term financial resources and long-term liabilities
3. Add contingent liabilities
4. Add operating fixed assets
5. Add non-operating fixed assets

Usefulness of Financial Statements. The usefulness of financial statements could be demonstrated by constructing financial indicators and ratios for assessing the soundness of public finances. Research and deliberations are currently underway at the IPSAS Board (2011) and the American government accounting standards boards on fiscal sustainability, economic conditions, financial projections, social benefits, long-term commitments, financial guarantees, employee pensions and other post-employment benefits. All these topics relate to assessing the soundness of public finances. At issue is whether the current financial statements are robust enough to address these concerns, or new financial statements or supplementary reports may be required. That would depend, in part, on how the soundness of public finances is conceptualized and measured. While Chan and Xu (2012) point out the significant differences in accounting and economic perspectives and methodologies, Irwin (2012) argues that “governments should disclose risks from implicit guarantees of the financial system and they should be encouraged to do so by the publication of detailed guidelines by IMF.”

Consolidation. By adopting the business model of financial reporting model (e.g. the IFRS), the IPSASs basically accept the consolidated format as the primary way of communicating a government’s financial information, as illustrated by the basic financial statements in the early part of this chapter. Based on the belief that economic substance overrides legal form, consolidation creates an economic family and a financial reporting entity consisting of legally independent entities. In the course of consolidation, the effects of transactions between the components of this reporting entity – in effect deemed irrelevant to external parties – are eliminated. For example, unless one searches the notes and disclosures, it is impossible to tell from the U.S. Government’s consolidated financial statements that the Social Security Fund has been lending annual cash surpluses to the General Fund in exchange of special Treasury securities. Thanks to this practice, the government's consolidated deficit is therefore smaller than the General Fund deficit. Since this and many other intra-government transactions have political, economic and financial consequences, it is recommended that they be identified and reported.

Accessibility and Friendliness of Financial Reports. There is a great need to make government financial information easily accessible and appealing to potential readers by taking advantage of the Internet. This media offers many opportunities to creatively structure and present financial information in an appealing manner. Beyond posting the PDF files of financial reports on the Internet, governments can do more to take advantage of the power of the digital communication media to lower the cost of becoming informed about the financial affairs of government (see Box 6).

Box 6. Government Financial Reporting in the Digital Age

In *An Economic Theory of Democracy* published in 1957, economist Anthony Downs classified a voter's cost of becoming informed about public affairs into transferable costs and non-transferrable costs. Among the transferable costs are: (a) procurement costs – the costs of gathering, selecting and transmitting information; (b) analysis costs – the costs of making factual analysis of data; (c) evaluative costs – the costs of relating data or factual analysis to specific personal goals. Recently, the American FASAB's Financial Reporting Model Task Force made the following recommendation to reduce the public's costs so that the public no longer have the excuse of remaining rationally ignorant about public finances:

> Move away from paper-based reporting and adopt an electronic, Web-based reporting method. The electronic, Web-based reporting method should be an integrated, highly interactive presentation that enables users to access financial information prepared in conformity with FASAB standards as well as under other reporting requirements of OMB [Office of Management and Budget], the Department of the Treasury, and federal law. An electronic, Web-based reporting method to provide a central source for federal financial information should

be adopted and designed to permit users to “drill-down” to the appropriate level of detailed material.

In that regard, the Web site data should be machine-readable so that users can conduct searches and download the data in different formats. Also, a multimedia approach should be used to convey information so that citizens can understand its significance and how it affects them. A centralized site would help those users who are not familiar with the organizational structure of the U.S. government and the information made available to the public. By focusing on highly interactive financial information, the site would provide the variety of information that different users seek.

Source: Report of the FASAB Task Force on Financial Reporting Model (FASAB, 2010).

Alignment of Three Reporting Systems. Accountants tend to think of financial reporting mostly as the preparation of year-end financial statements and reports. This view is not wrong but is unduly narrow given the legitimate and complementary roles of the government budget and government finance statistics. Even though each of these reporting systems has its own theoretical foundations, perspectives and objectives, they share much in common and there is much to be gained by intensifying the coordination and cooperation of the budgeting, accounting and statistical offices at the international, regional and national levels. The IPSAS Board and several countries have largely succeeded in harmonizing government accounting standards with corporate IFRS.[xi] It is even more important and urgent to harmonize IPSAS with the GFS Manual. With regard to budgetary reporting, it appears that only reconciliation is possible presently since the accrual basis is not a common budgeting practice in most countries.

From Adoption of Standards to Implementation of Policies. Thanks in no small measure to the coalition in support of the IPSAS Board, accrual accounting has gained considerable acceptance as a matter of principle. As indicated in the previous chapter, it is compatible with and supportive of an economy system that operates on credit in both the private and public sectors. While many skeptics remain, more governments are being persuaded as to the merit of accrual accounting and accrual-based financial reporting. There will come a time – perhaps the time has come – that the affirmation decision to adopt accrual accounting and reporting standards would require substantial investment in financial and human capital in their actual implementation. We therefore again urge international, regional, as well as institutional and professional, cooperation to increase the efficiency and return of this investment.

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Notes

[i] Accounts are individual financial records. However, accounts could also be financial statements that summarize data from those records, e.g. whole-of-government accounts, a common British usage.

[ii] In a democracy, directly elected offices and institutions are endowed with greater authority. Proximity to the ultimate power of the electorate is a basic criterion for ordering control relationships.

[iii] Standardization of budgetary reporting is usually the concern of individual jurisdictions or budget offices at the provincial or national level. Standardization of statistical reporting is a matter at the national and international levels. Due to space limitations, this chapter will not elaborate on standards for these types of reporting.

[iv] The illustrations should be viewed in the context of an entire financial report of a particular government, which cannot be duplicated in this chapter.

[v] Unlike the Government Finance Statistics (GFS), there is not a separate statement of "economic flows" to reflect the changes in market values of assets and liabilities. To accountants, these changes are *unrealized* holding gains and losses, whose recognition in financial statements is hotly debated. If recognized, they and realized gains and losses would be combined with (operating) net income to arrive at comprehensive income, which is change of total net assets during the period.

[vi] Liabilities may be classified in various ways to serve different analytical purposes. For example, the GASB stresses "operating debts" (such as pension benefits and other post-employment benefits) which are deferred costs of services, in contrast to bonded debts evidenced by securities. Liabilities could be direct (the government's own debt) or indirect (e.g. guarantees for other borrowers); certain or contingent. From a legal standpoint, the seniority of creditors' claims is an important consideration.

[vii] Cash budgeting regards as expenditures the amounts lent to others or used to purchase ownership interests of a business. These cash expenditures would result in loans receivable and financial investments, with no effect on the government's results of operations.]

[viii] A task force appointed by the IPSAS Board and organizations responsible for SNA and GFS to study the issued its report in 2006. The IPSAS Board issued No. 22 on the disclosure about General Government Sector and currently has a project on alignment with GFS. As of February 2012, the task force is working on update the 2006 report to reflect subsequent developments, and is preparing an appendix to GFSM 2001 to explain the similarities and differences between financial reporting and statistical reporting.

[ix] A jurisdiction is an area in which the same rules are applied. It could be a government, a group of governments, a nation or a group of nations.

[x] We would suggest that it be renamed a "cash accounting" implementation guide, because the existence of an exceptional cash-basis IPSAS contradicts the whole body of accrual-basis IPSAS. Since the objective is to produce reliable cash information, the consolidated reporting requirement would also be dropped, along with the budgetary reporting and provisions for accounting for external assistance.

[xi] U.K., Australia and New Zealand, the early leading advocates of IPSAS, have ironically opted for IFRS as the foundation of their government accounting standards (see HM Treasury, November 29, 2011 statement on the

release of the 2010 WGA; Newberry, 2007; Robb and Newberry, 2007; and New Zealand Controller and Auditor-General, 2008).]