THE STRUCTURE AND CHOICES IN AMERICAN GOVERNMENT ACCOUNTING STANDARDS

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Governments are urged to be transparent about their finances. This is usually done by disclosing their budgets in advance of a fiscal year and by issuing financial reports after the fiscal year is over. The requirements for budget preparation, approval and enforcement are typically codified in budget laws. After examining the budget laws of a dozen OECD (Organization for Economic Cooperation and Development), Lienert and Jung enunciated ten principles for a budget law. In addition to the paramount principle of authoritativeness, the others include the classical principles of annual basis, universality, unity, specificity and balance, as well as modern principles of accountability, transparency, stability and performance (see Appendix 1 for a summary statement of these principles). No such succinct statements of principles, however, exist for year-end financial reporting by government. Instead, there are many standards: there are 24 IPSAS (International Public Sector Accounting Standards), in additional to national standards. Speaking of national standards, in the United States alone, a total of more than eighty standards have been developed by the Federal Accounting Standards Advisory Board (FASAB) and the [State and Local] Governmental Accounting Standards Board (GASB) over the past 25 years.

It is intellectually challenging and extremely time consuming to make sense of government accounting standards, which are often technical, complex and full of jargon. This paper proposes a framework for organizing government accounting standards, which may be classified into ten aspects. Along each aspect, conceivable possibilities are identified so that even the options rejected by accounting standards are made known. The options that have been chosen by the FASAB and GASB are briefly described and illustrated by sample financial statements in another appendix. Finally, a tentative set of government accounting *principles* are offered.

I. A Framework for Government Accounting Standards

A. Introduction

In setting standards, the GASB and FASAB have in effect been accepting some options and rejecting others. For example, {accrual basis, a fund, cash basis, a whole government} are a set of alternative accounting policy options. But accrual basis and cash basis are alternative bases of accounting, while a fund and a whole government are alternative reporting entities. Therefore government accounting standards can be organized into various aspects. Some aspects are independent, such as reporting entity and basis of accounting; others are related, such as measurement focus and basis of accounting. The task of standard-setters is to identify and evaluate the options along each of the aspects.

B. Ten Aspects of Government Accounting Standards

The ten aspects of government accounting standards correspond to the ten areas of concern to government accountants:

1. What should be the capability and objectives of a government's accounting system?
2. What should be the relationship between a government's budget and its accounts and financial statements?
3. What should be a government's accounting and reporting entities?
4. How should a government's accounts be kept?
5. What financial statements are necessary and how are they related?
6. Should financial accounting deal only with the past?
7. What criteria should be used to recognize some resources as assets and some obligations as liabilities?
8. What kinds of assets and liabilities should be reported in the balance sheet?
9. How should revenues and expenses or expenditures be measured?
10. What should be the unit of financial measurement, and relatedly the valuation bases for assets and liabilities?

These questions may be referred to as follows:

1. Capacity and objectives
2. Relation with the budget
3. Accounting and reporting entity
4. Accounting system architecture
5. Financial statements
6. Realization (or time orientation)
7. Recognition
8. Measurement focus
9. Basis of accounting
10. Unit of measurement and valuation basis

C. Multiple Choices

Each one of the above questions can often be answered in more than one way. Thus standard setting amounts to making one or more selections from the set of possibilities. To the author's best knowledge, the possibilities are identified below.

1. ***Capacity and Objectives***. A government's accounting system can be designed to achieve one or more of the following objectives:
   (a) monitoring legal – including budgetary – and contractual compliance
   (b) accurately measure and communicate financial consequences of past decisions and actions
   (c) prepare budgets and cost analyses

2. ***Relation with the Budget***. Possible relationships between accounting and budgeting include:
   (a) accounting follows budget concepts and measurement rules
   (b) budgeting rules are used in making actual-to-budget comparisons
   (c) accounting concepts and measurement rules are independent of those of budgeting

(d) budgeting uses accounting concepts and measurement rules

3. ***Accounting and Financial Reporting Entity***. Possible accounting and financial reporting entities include:
   (a) the government as a whole, along with the entities it owns or controls
   (b) only the government as a whole
   (c) major lines of activities (e.g. governmental, business, fiduciary) and the government as a whole
   (d) components of a government, e.g. funds, organizational units

4. ***Accounting System Architecture***. The accounting system could be:
   (a) a single entry system
   (b) a double entry system, which is based on the accounting equation: assets = liabilities + net assets.
   Since virtually all financial accounting systems are based on the double-entry system, from now on, this recording system is assumed.

5. ***Financial Statements***. The choice of the double-entry recording system and the underlying conceptual model leads to two fundamental financial statements: a statement of financial position at the end of a period, and a statement of financial performance for a period, with financial performance expressed in terms of changes in net assets, and therefore changes in assets and liabilities (see Exhibit 1).

Exhibit 1: Financial Position and Performance

Stock and Flow Measures	Accounting Equation
Financial position at the end of period t	Assets_t - Liabilities_t = Net Assets_t
Financial performance in period 1:	
Revenue	increase decrease increase
Expense	decrease increase decrease
Financial position at the end of period t+1	Assets_{t+1} - Liabilities_{t+1} = Net Assets_{t+1}

6. *Realization*. Realization means awaiting actual transactions or events to confirm estimates about the value of an asset or liability. Financial accounting could admit into the accounting system
   (a) only with the consequences of what has happened, and/or
   (b) estimates about what has not happened in limited circumstances (e.g. unrealized gains or losses of financial investments)
   (c) estimates about what has not happened in many situations

7. *Recognition*. Related to "realization" are the criteria used to define certain resources as assets and certain obligations are liabilities. The asset recognition criteria could include one or more of the following:
   (a) future service potential
   (b) ownership
   (c) control
   (d) as a consequence of past transactions or events
   The liability recognition criteria could include:
   (a) future cash outflow or service delivery
   (b) cannot be avoided

(c) definite amounts and timing
(d) as a consequence of past transactions or events

8. ***Measurement Focus***. Measurement focus refers to the extent to which the scope of assets and liabilities is stretched as described in Exhibit 2. In both cases, there is the issue of timing: short-term and/or long-term, as well as the type of assets and liabilities.

Exhibit 2: Measurement Focus Possibilities

Panel A: Assets			
Type / Timing	Financial Resources	Non-financial Resources	
		Non-capital	Capital
Current	yes or no	yes or no	(null)
Non-current	yes or no	yes or no	yes or no

Panel B: Liabilities		
Type / Timing	Operating Debts	Capital Debts
Current	yes or no	yes or no
Non-current	yes or no	yes or no

Operating debts are service costs deferred to the future for payment (e.g. employee retirement pension and health care benefits). Capital debts are borrowings to finance acquisition or construction of fixed assets.

9. *Basis of Accounting***.** Basis of accounting refers to the method used to measure revenue, expenses or expenditures. In addition to the "budgetary basis," which does not have standard meaning (other than including contractual obligations as spending), two major alternatives are:
(a) cash basis
(b) accrual basis

In business accounting, where most transactions are reciprocal exchanges, the accrual basis has a more standard meaning: revenue is recognized to the extent of goods sold or service delivered, i.e. based on service efforts and accomplishments (SEA), with far more emphasis on accomplishment (sale) than on effort (production). Expenses are all the assets used and liabilities incurred in generating the revenue so recognized. The matching of revenues and expenses in this manner results in income. This SEA-based accrual is sometimes called full accrual, and is also used in measuring the performance of business-type activities of government.

Accounting for governmental activities and governmental funds uses a basis that falls short of the full accrual basis of accounting. Exact what it is has not been fully clarified. The government-wide financial statements required by GASB Statement *No. 34* uses an accrual basis, in contrast to the modified accrual basis used to prepare governmental fund financial statements. In order to clarify the extent of modification of accrual and to convey the idea that accrual is a continuum and can be stretched a little bit or very far, the author has suggested the notion of *degrees of accrual* (Exhibit 3).

Exhibit 3: The Degrees of Accrual

Revenue	**Degrees of**	

	Accrual	Expense/Expenditure
recognition on the basis of service efforts and accomplishments (SEA)	full (accrual basis)	recognition triggered by matching revenues with the economic resources used to generate them, and the incurrence of liabilities regardless of timing
recognition on the basis of legally enforceable claim	strong	expense: use of economic resources (i.e. capital asset depreciation), and the incurrence of liabilities regardless of timing
recognition on the basis of the availability of financial resources regardless of timing of conversion of cash	moderate	expense: use of financial resources, and incurrence of financial liabilities regardless of timing of future cash outflows
recognition on the basis of the availability of current financial resources	mild (equivalent to the GASB's modified accrual)	expenditure: use of current financial resources, and the incurrence of current liabilities

10. *Unit of Measurement and Valuation Basis*. In the United States, it is taken for granted that the U.S. dollar is the unit of measurement in government accounting and financial reporting. Also historical cost is assumed as the valuation basis for assets and liabilities. But there are other possibilities, which have been extensively discussed in the business accounting literature, but have hardly been explored in governmental accounting:

Possibilities for unit of measurement:
(a) unadjusted U.S. dollar
(b) U.S. dollar adjusted for general price-level changes (i.e., inflation)
(c) U.S. dollar adjusted for specific price-level changes
Possibilities for asset valuation basis:
(a) historical cost
(b) historical cost adjusted for price level changes
(c) net realizable value
(d) current replacement cost
(e) present value of future cash flows
Possibilities for liability valuation basis:
(a) contractual amount
(b) present value of future amounts
(c) actuarial value (with uncertainty and other factors taken into account) of future amounts

To sum up, there are ten aspects in the structure of government accounting standards. Along each aspect, there is often more than one possible choice. Accounting standard setting involves activities at two levels: (1)

sequencing the aspects for setting the agenda for standard setting, and (2) for each dimension, deciding which option or options to require or permit their use.

Academics and practitioners in other countries may not have the time, even if they have the interest, to know all the more than eighty FASAB and GASB standards. Therefore next section casts the choices embodied in the GASB and FASAB standards in the context of the structure described in this section.

II. A Characterization of American Government Accounting Standards

Characterization of American government accounting standards means to describe those standards in terms of the choices identified above. This is a high-level characterization intended to inform the reader about the significant features of the two sets of American government accounting standards.

A. Capacity and Objectives; Relation with the Budget

Both the FASAB and GASB focus their standards on financial accounting – the measurement and communication of financial consequences of past decisions and actions – and general purpose external financial reports. However, both boards recognize that a government accounting system requires the capacity to monitoring legal – including budgetary – and contractual compliance, and the necessity of other (special purpose) reports. This external reporting emphasis has to be seen as building upon the earlier objectives of eliminating pervasive financial corruption and supporting financial management.

With regard to the relationship between financial accounting and the budget, both the FASAB and GASB are not empowered or permitted to determine budget concepts or set budgeting standards. However, government accounting cannot avoid interacting with government budgeting. The interactions take place in several ways under different rules:

- Budget concepts and measurement rules are used in the preparation of budget execution reports during the fiscal year in both the Federal Government and state and local governments.
- Actual-to-budget comparisons are made in year-end financial statements in state and local governments, but not in the Federal whole-of-government or agency financial statements.
- When the budgetary basis differs from the accounting basis, numbers prepared under different rules are reconciled (i.e. explained) in both Federal and state/local government reports.
- GASB and FASAB standards are not constrained by budget rules (e.g. liabilities are recognized regardless of whether they are funded or not). Similarly, American government budgeting generally does not use accounting concepts and measurement rules (e.g. the long-term perspective of the balance sheet, and accrual basis in recognizing revenues and expenses).

B. Accounting and Financial Reporting Entity

Both the FASAB and GASB require the preparation of government-wide financial statements, which do not include fiduciary activities. However, the Federal Government's whole-of-government financial statements are consolidated, with one column for the entire government. A state or local government's financial reporting entity includes the primary government and discretely presented component units for which the primary government is financially accountable. Furthermore, the primary government's governmental activities and business-type activities are separately reported, before they are summed up in the government-wide totals. The interactions among Federal activities (e.g. the general fund and social security trust funds) are described in a financial statement.

Virtually all major Federal Government agencies prepare and separately issue agency-wide financial statements using FASAB standards. State and local governments typically do not publish departmental financial statements. Rather, fund financial statements are considered to be an integral part of a government's basic financial statements, along with the government-wide financial statements, in the government's comprehensive annual financial statements (CAFR).

C. Accounting System Architecture and Financial Statement

FASAB and GASB standards are based on the premise that governments use the double-entry recording system. Both boards do not prescribe charts of accounts, leaving this task to the governments themselves. In the case of the Federal Government, the Financial Management Service in the Treasury Department requires Federal agencies to adopt the requirements of the Standard General Ledger. GASB only requires governments to have uniform terminology and account classification.

The implicit adoption of the double-entry recording system by the FASAB and GASB results in two fundamental financial statements: a statement of financial position at the end of a period, and a statement of financial performance for a period for all governments. However, the Federal Government also separately publishes a whole-of-government statement of cash receipts, outlays and balances; therefore there are two schedules to reconcile the accrual-based deficit numbers to cash deficits and to the cash balance numbers. There is, however, a stand-alone statement of social insurance. There are additional financial statements mainly related to budget performance in Federal agency reporting and in state/local fund reporting.

D. Realization

Both the FASAB and GASB are limited by their charters to focus their standard setting to accounting in general and financial accounting in particular. (The FASAB has devoted a limited amount of time and two standards to cost accounting, even though it explicitly identifies its standards as financial accounting standards.) This strategic direction implies a commitment to the realization principle in financial accounting. The realization principle basically says that financial accounting deals mainly with the consequences of what has happened, and does not engage in projections or speculations about what will (or will not) happen. Thus deferred maintenance is not measured for reporting in the financial statements, but could be disclosed in the notes to the financial statements or elsewhere in the financial report.

The commitment to the realization principle does not preclude financial accounting from estimating the present and future financial consequences of past transactions or events. For example, the calculation of depreciation expense and allowance for uncollectible accounts both require estimates about the future. But in both cases, the starting point is the transactions or events that have happened.

E. Recognition, Measurement Focus and Basis of Accounting

Both the FASAB and GASB use similar criteria to recognize certain resources as assets and certain obligations are liabilities. The asset recognition criteria include all of the following: (a) having future service potential, (b) the government's ownership or effective control, and (c) a consequence of past transactions or events. In order to complement the partial disclosure, the Federal Government describes its "stewardship assets" in separate schedules. The GASB has not given specific guidance regarding the disclosure of off-balance sheet assets.

The liability recognition criteria include all of the following: (a) necessitating future cash outflow or service delivery; (b) unavoidable and having definite amounts and timing, and (c) a consequence of past transactions or events. In order to complement the partial disclosure, the Federal Government describes its "stewardship responsibilities" in separate schedules. (Currently there are debates on whether the Federal Government social insurance obligations are an off-balance sheet responsibility or an on-balance sheet liability.)

The application of the liability recognition criteria rules out the recognition of obligations under executory (i.e. unperformed) contracts as liability. GASB standards requires contractual obligations be reported as a classification of fund balance (an increase in reserved fund balance, offset by a decrease in unreserved fund balance). FASAB standards require the disclosure of these obligations as part of the statement on the sources and uses of budgetary resources at the agency level.

The above recognition criteria are designed with the government's interactions with external parties in mind. Federal agency balance sheets report intra-governmental assets and intra-governmental liabilities. In particular, in a practice that seems to deviate from the realization principle, Federal government agencies recognize budgetary resources (appropriations by Congress) as an asset. This lead to recognizing the appropriations as an increase in intra-governmental asset, i.e., "fund balance with Treasury," which then triggers the recognition of unexpended appropriations as part of the agency's net asset.

In terms of the big picture, both the GASB and FASAB have taken giant steps in broadening the measurement focus of the balance sheet. In particular, the Federal Government makes a point of extensively reporting Stewardship Assets and Stewardship Responsibilities – Federal resources and responsibilities that do not meet the above recognition criteria, or cannot be feasibly measured in financial terms. Thus American governments at all levels report a full range of financial resources and non-financial resources, including infrastructure and other capital assets (Exhibit 4).

Exhibit 4: Measurement Focus: Assets

Type / Timing	Financial Resources	Non-financial Resources	
		Non-capital	Capital
Current	yes	yes	not applicable
Non-current	yes	yes	yes

American governments have done well in recognizing, measuring and reporting short-term liabilities. However, it is in the long-term liability area that problems and controversies abound. Recall that Panel B of Exhibit 2 sets forth a conceptual classification scheme for liabilities along two dimensions: current vs. non-

current, and operating debts vs. capital debts. This classification can help us analyze the distinctive liability recognition problems of the Federal Government, and state/local governments.
The Federal Government does not classify its liabilities in terms of operating debts and capital debts, in part because the Federal Government as a whole does not have a capital budget to be financed by borrowing specifically for capital expenditures. Thus it is impossible to know (a) the size of the Federal Government's operating deficit, and (b) how much of the borrowing is for capital acquisition. The Federal Government does recognize pension and benefits payable to civilian and military employees – both current and retired.

American state and local governments typically separate their budgets into operating budgets and capital budgets. Operating budgets are usually required by law to be balanced, and capital budgets are generally financed by long-term borrowing and capital grants, and some current revenues if possible. As bonds issued for capital acquisition are subject to extensive capital market surveillance and scrutiny, it is in the area of operating debts that the GASB has exerted more effort and influence. There are two kind of operating debts: the first kind is explicit borrowing to cover operating deficit; the second kind is the costs of current services deferred to the future for payment. The GASB has issued a number of standards to require state and local governments – as employers and as sponsors of public employee retirement plans/systems – to disclosure long-term information about their unfunded actuarial liabilities for both pension benefits and other post-employment benefits (OPEB), notably health care.

The recognition of long-term operating debt is coordinated with the push in the direction of higher degrees of accrual. In principle, both GASB and FASAB standards are in favor of the strong degree of accrual. At that level, cost of government services includes not only cash outlays (e.g. salaries paid), increase in current liabilities (e.g. salaries payable soon), but also increase in long-term liabilities (e.g. pension and OPEB payable), and the cost of using capital assets (i.e. depreciation expense). The challenge lies in the implementation of these farsighted standards in reporting, and ultimately in motivating politicians to raise taxes to amortize unfunded liabilities.

On the revenue side, both the GASB and FASAB are also committed to the strong degree of accrual in principle in recognizing taxes, grants and other revenues form non-exchange transactions. The Federal Government has candidly admitted that it uses a near-cash basis in recognizing income taxes (which account for about 90% of its total revenues) probably because (a) the government already collects most of the taxes in cash through the employee payroll withholding system and periodic payments of estimated taxes of businesses, and (b) it is too costly to measure tax revenue on the basis of legally enforceable claim.

F. Unit of Measurement and Valuation Basis

Neither the FASAB nor the GASB has issued standards specifically dealing with the unit of measurement issue. The lack of valid and reliable financial measurement has hampered the integration of "Stewardship assets" onto the Federal Government balance sheet. Furthermore, since financial measurement is inadequate for gauging service efforts and accomplishments, the GASB has kept its SEA reporting project alive.

By default, American governments use the nominal U.S. dollar as unit of measurement in accounting and financial reporting. There are no adjustments for either general or specific price-level changes. Similarly, the historical cost basis is used without active consideration of systematic use of alternatives such as net realizable value, current replacement cost and the present value of future cash flows. However, actuarial valuations are commonly used in connection with measuring the amounts of pension and OPEB liabilities.

In conclusion, even without overt coordination, GASB and FASAB standards have achieved a degree of convergence to the point we can at least attempt to make some general statements about American government accounting and financial reporting standards. This is done in the next section.

III. Ten Government Accounting Principles

For jurisdictional reasons, the FASAB and the GASB have been respectively setting generally accepted accounting principles (GAAP) applicable to the Federal Government, and to state and local governments. Despite the numerous differences in their standards, both boards favor full disclosure for demonstrating and assessing government accountability, and both use essentially the same due process, even though their larger governance structures are quite dissimilar. Consequently, there are enough common features to constitute a set general American government accounting principles.

Following is the author's tentative formulation of such a set of general American government accounting principles. The word "principles" is chosen to distinguish them from the "standards" set by the GASB and FASAB, and to make the point that these are broader and more general than most of the standards. But the principles are intended to be more concrete than a conceptual framework. As the FASAB and GASB have produced so many statements of standards by now, it is both necessary and worthwhile to generalize them to the extent possible. Both the GASB and FASAB have produced periodic "codifications" of their standards. But codifications are largely compilations of existing provisions of the standards to take into account additions, amendments and repeals. The following principles, however, are more in the nature of a distillation than a condensation of current standards. It goes without saying that they are the product of one academic's attempt to make sense of American government accounting standards, and they have no official standing.

Principle 1. Accounting System Capability and Objectives. A government's accounting system should have the capacity to support financial management, as well as to provide information for demonstrating and enforcing legal and budgetary compliance, and financial accountability. When financial information is intended for external users, it is expected to be in conformity with applicable generally accepted accounting principles (GAAP).

Principle 2. Relation to the Budget. Governments should prepare and make public their annual budgets in terms of projected revenues and authorized expenditures. Actual and expected financial performance should be compared, using the budgetary basis, during the fiscal year and at year-end. When there are differences in scope of coverage and measurement methods, budgetary and accounting information should be reconciled.

Principle 3. Accounting and Reporting Entity. Accounting and reporting entities are identified on the basis of accountability and decision-making authority. These entities should include the whole government and its components, as well as legally separate but financially interdependent organizations. Financial data should be sufficiently disaggregated to allow flexible combination of entities for different purposes.

Principle 4. ***Accounting System Architecture***. Government accounting should use the double entry recording method and be based on the accounting equation: assets = liabilities + net assets, where changes in net assets are reflected by revenues and expenses. A chart of accounts elaborating the classification of these elements of the accounting equation should be used consistently throughout the budgeting, accounting and financial reporting cycle.

Principle 5. ***Financial Statements***. Financial statements are the core of interim and annual financial reports. By virtue of the relationships between the elements of the accounting equation, the statement of financial position is related to the statement of financial performance, and the cash flow statement is related to cash balances. Every government should prepare and make public a set of government-wide financial statements, as well fund or departmental financial statements. The government-wide financial statements should be designed so as to reveal significant internal financial relationships. Additional required and discretionary disclosures could be made to supplement and complement these fundamental financial statements.

Principle 6. Realization or Historical Orientation. Financial accounting data reflect the effects of past transactions and events on the financial position, financial performance and cash flows of an entity. This historical orientation constraints financial statements to reporting mostly realized results and using the historical cost as the basic valuation method.

Principle 7. Accounting Recognition. Economic resources capable of producing future benefits and acquired, owned or controlled by an entity should be regarded as its assets. An entity's obligations to pay cash or provide services as a consequence of past transactions and events should be regarded as its liabilities. Net assets or fund balance results from assets being offset by liabilities. Contractual obligations are not liabilities and may be disclosed in the net assets or fund balance. If intra-governmental assets and liabilities are reported, they should be clearly identified.

Principle 8. Measurement Focus. The statement of financial position should have a broad measurement focus. As such, assets encompass capital assets in addition to short- and long-term financial resources, and for liabilities encompass both capital debt and operating debt regardless of the timing of their maturity. Assets and liabilities should be classified so as to facilitate the assessment of the entity's liquidity and solvency.

Principle 9. Basis of Accounting. Government should adopt an accrual basis of accounting, even though there are varying degrees of accrual. Full accrual of revenues in exchange transactions should be based on service efforts and accomplishments, and the related expenses are cost of all the assets used and all liabilities incurred to generate the revenue. Degrees of accrual range from mild accrual, to moderate accrual, and to strong accrual. They differ in terms of the assets and liabilities being included in revenues and expenses (or expenditures). Which degree of accrual to adopt depends on the objectives of measuring revenue and cost of service, and should be guided by cost and benefit considerations.

Principle 10. Measurement Unit and Valuation Basis. Financial records and financial statements usually are not adjusted for decrease (or increase) in the purchasing power of the measurement unit, i.e. the U.S. dollar. However, during periods of significant inflation, financial trend information should be so adjusted. If liabilities occur over a long period of time, actuarial valuation should be used. The historical cost basis is generally used, except for the use of fair value for financial assets and actuarial estimates for certain long-term liabilities.

This paper has described the standards promulgated by the Federal Accounting Standards Advisory Board (FASAB) and the Governmental Accounting Standards Board (GASB). Since their establishments – FASAB in 1990 and GASB in 1984 – these boards have issued over eighty standards and succeeded in resolving many accounting and financial reporting issues. In the spirit of "*gongfu tea*" – less volume for greater potency – this paper has offered ten principles so that at a glance the international reader could capture the essence of American government accounting.

Note

An earlier version of this paper appeared as "Less Is More: Principles for Government Accounting," *Stand und Perspektiven der Oeffentlichen Betriebswirtschaftslehre II*, Festschrift für Prof. Dr. Dr. h.c. mult. Peter Eichhorn anlaesslich seiner Emeritierung (*State and Perspectives of Public Sector Management II*, Honorary Publication for Prof. Dr. Dr. h.c. mult. Peter Eichhorn on the occasion of his retirement), edited by Dietmar Braeunig and Dorothea Greiling (Berlin: Berliner Wissenschafts-Verlag, 2007), pp. 650-663. This paper also draws on the author's other writings, which can be found at JamesLChan.com.

References and Further Readings

Chan, James L. "Government Accounting: An Assessment of Theory, Purposes and Standards," *Public Money and Management* (January, 2003), pp. 13-20.

Ian Lienert and Moo-Kyung Jung, The Legal Framework for Budget Systems: An International Comparison, *OECD Journal on Budgeting*, Special Issue (Volume 4, No. 3).

Federal Accounting Standards Advisory Board (FASAB), Statements of Federal Financial Accounting Standards and Statements of Federal Financial Accounting Concepts; original pronouncements, codification and documents generated for the due process are available at www.fasab.gov.

Governmental Accounting Standards Board (GASB), Governmental Accounting and Financial Reporting Standards, Original Pronouncements and Codification, and documents generated for the due process are available for purchase from the GASB, www.gasb.org.

Appendix 1

Ten Principles for Budget Law

1. **Authoritativeness**: Where decision-making authority lies is specified at each of the stages of the budget process … The supremacy of the legislature in budget matters is an integral part of this principle.

Classical principles

2. **Annual basis**: Budget authority is provided for a 12-month period. The annual budget is enacted prior to the year to which it refers. All transactions are estimated for their one-year effect.
3. **Universality**: All revenues and expenditures are included in the budget on a gross basis. Revenues are not earmarked. Expenditures are not offset by revenues.
4. **Unity**: The budget presents, and may seek approval for, all receipts and payments at the same time, usually in the same document.
5. **Specificity**: Revenues and expenditures are shown with some detail in the budget estimates. Spending authorizations (appropriations) show legally binding maximum expenditures for particular purposes.
6. **Balance**: Budget expenditures are balanced by budget revenues and financing. "Balance" is well-defined.

Modern principles

7. **Accountability**: The executive gives an account of how it meets its responsibilities to the legislature. Within the executive, the accountability of budge managers is clearly defined. An independent external audit body reports at least annually to the legislature on budge execution.
8. **Transparency**: The roles of various State bodies are clear. Timely financial and non-financial information on the budget is publicly available. The terms used in the budget law are clearly defined.
9. **Stability**: Budget and public debt objectives are framed in the context of a regularly updated medium-term budget framework. The rates and bases of taxes and other charges are relatively stable.
10. **Performance**: The expected and recent past results of budget programmes are reported in the budget. The principles of efficiency, economy and effectiveness are associated with "performance."

Source: Ian Lienert and Moo-Kyung Jung, *The Legal Framework for Budget Systems:* An *International Comparison* (2004), p. 133

Appendix 2

Illustrative Financial Statements of American Governments

Structure of Exhibits

Financial Statements	Federal Govt.	State/Local Govt.
Financial Position	**1**	**2**
Financial Performance	**3**	**4**
Budget Reconciliation	**5**	*
Budget Comparison		**6**

* omitted, part of budget comparison

List of Exhibits

1. Consolidated Balance Sheets of the United States Government
2. Government-wide Statement of Net Assets of a State/local Government
3. Consolidated Statements of Net Costs and Consolidated Statements of Operations and Changes in Net Position of the United States Government
4. Government-wide Statement of Activities of a State/local Government
5. Reconciliations of Net Operating Cost [accrual deficit] and Unified Budget Deficit [cash deficit] of the United States Government
6. Budget Comparison Schedule of the General Fund of a State/local Government

Exhibit 1

United States Government
Balance Sheets
As of September 30, 2005, and September 30, 2004

(in billions of dollars)	2005	2004
Assets		
Cash and other monetary assets	$86	$97
Accounts receivable, net	44	35
Loans receivable, net	222	221
Taxes receivable, net	22	21
Inventories and related property, net	272	261
Property, plant and equipment, net	678	653
Securities and investments	75	57
Other assets	57	52
Total assets	$1,456	$1,397
Liabilities		
Accounts payable	68	60
Federal debt securities held by the public and accrued interest	4,624	4,330
Federal employee and veteran benefits payable	4,492	4,062
Environmental and disposal liabilities	260	249
Benefits due and payable	117	103
Insurance program liabilities	93	62
Loan guarantee liabilities	48	43
Other liabilities	213	198
Total Liabilities	$9,915	$9,107
Contingent liabilities and Commitments		
Net position	(8,459)	(7,710)
Total liabilities and net position	1,456	1,397

Exhibit 2

Sample City
Statement of Net Assets
December 31, 2002

Dollar amounts in thousands	Primary Government			
	Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
ASSETS				
Current assets:				
Cash and cash equivalents	$ 13,598	$ 8,786	$ 22,383	$ 304
Investments	27,365	-	27,365	7,429
Receivables (net)	12,833	3,609	16,443	4,042
Internal balances	175	(175)	-	-
Inventories	322	127	449	84
Total current assets	54,293	12,347	66,640	11,859
Noncurrent assets:				
Restricted cash and cash equivalents	-	1,493	1,493	-
Capital assets (Note 1):				
Land and infrastructure (see G-5)	118,620	34,788	153,409	751
Depreciable buildings, property, and equipment, net	51,403	116,601	168,003	36,994
Total noncurrent assets	170,023	152,882	322,905	37,745
Total assets	$ 224,316	$ 165,229	$ 389,545	$ 49,604
LIABILITIES				
Current liabilities:				
Accounts payable	$ 6,783	$ 752	$ 7,535	$ 1,803
Deferred revenue	1,436	-	1,436	39
Current portion of long-term obligations (Note 2)	9,236	4,426	13,662	1,427
Total current liabilities	17,455	5,178	22,633	3,269
Noncurrent liabilities:				
Noncurrent portion of long-term obligations (Note 2)	83,302	74,482	157,784	27,106
Total liabilities	100,757	79,660	180,417	30,375
NET ASSETS				
Invested in capital assets, net of related debt	103,711	73,089	176,800	15,906
Restricted for:				
Capital projects	11,706	-	11,706	493
Debt service	3,021	1,452	4,473	-
Community development projects	4,811	-	4,811	-
Other purposes	3,214	-	3,214	-
Unrestricted (deficit)	(2,904)	11,028	8,124	2,830
Total net assets	123,559	85,569	209,128	19,229
Total liabilities and net assets	$ 224,316	$ 165,229	$ 389,545	$ 49,604

Source: GASB No. 34, p. 202, A-2

Exhibit 3

United States Government
Statements of Net Cost
For the Years Ended September 30, 2005, and September 30, 2004

(in billions of dollars)	Gross Cost 2005	Earned Revenue 2005	Net Cost 2005	Gross Cost 2004	Earned Revenue 2004	Net Cost 2004
Department of Defense	704	27	677	672	22	650
Department of Health & Human Services	623	40	584	584	44	550
Social Security Administration	572	(2)	574	535	3	532
Department of Veterans Affairs	276	3	273	51	3	48
Interest on Treasury Securities held by the public	181	-	181	158	-	158
Department of Agriculture	113	20	93	84	8	76
Department of the Treasury	82	3	79	79	4	75
Department of Education	76	5	71	64	5	59
Department of Homeland Security	75	7	68	46	6	40
Department of Transportation	62	0	62	57	1	56
Department of Labor	50	-	50	59	-	59
Department of Energy	47	4	43	27	5	22
Department of Housing and Urban Development	43	1	42	42	1	41
Department of Justice	27	1	26	35	1	34
Office of Personnel Management	33	14	19	22	14	8
National Aeronautics and Space Administration	16	0	16	17	0	17
Department of the Interior	19	3	16	19	2	17
Department of State	16	2	14	14	1	13
Agency for International Development	13	0	13	11	0	11
Railroad Retirement Board	10	-	10	9	-	9
Environmental Protection Agency	9	0	9	9	0	9
Department of Commerce	9	1	8	9	1	8
Federal Communications Commission	7	0	7	8	1	7
National Science Foundation	5	-	5	5	-	5
Federal Deposit Insurance Corporation	1	0	1	1	0	1
Small Business Administration	1	0	1	2	0	2
Pension Benefit Guaranty Corporation	5	4	1	17	4	13
U.S. Nuclear Regulatory Commission	1	1	0	1	1	0
Tennessee Valley Authority	9	9	0	8	8	0
National Credit Union Administration	0	0	0	0	0	0
General Services Administration	0	0	0	-	1	(1)
Export-Import Bank of the United States	0	3	(3)	1	3	(2)
U.S. Postal Service	56	69	13	54	68	(14)
All other entities	30	7	23	31	11	20
Total	3,175	225	2,950	2,732	207	2,525

United States Government
Statements of Operations and Changes in Net Position
For the Years Ended September 30, 2005, and September 30, 2004

(in billions of dollars)	**2005**	**2004**
Revenue:		
Individual income tax and tax withholdings	1,690	1,512
Corporation income tax	272	184
Unemployment taxes	40	37
Excise taxes	71	72
Estate and gift taxes	25	25
Customs duties	22	21
Other taxes and receipts	47	48
Miscellaneous earned revenues	19	14
Total revenue	2,185	1,913
Less net cost of Government operations	2,950	2,525
Unreconciled transactions affecting the change in net position *	4	(3)
Net operating cost	(760)	(616)
Net position, beginning of period	(7,710)	(7,094)
Change in accounting principle #	4	-
Prior period adjustments	7	-
Net operating cost	(760)	(616)
Net position, end of period	(8,459)	(7,710)

* The $4.3 billion "plug" figure was needed in fiscal year 2005 to reconcile the ending balances with the results of operations, after considering adjustments for changes in accounting policy and for prior period's numbers. In other words, $4.3 billion worth of transactions could not be reconciled in that year. This item will be further explained later.

$3.6 billion of adjustments were needed when the Air Force changed its inventory valuation method from Latest Acquisition Cost to Moving Average Cost. This had a favorable impact on the net position.

Exhibit 4

Statement of Activities
For the Year Ended December 31, 2002

Dollar amounts in thousands

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets — Primary Government			
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Governmental Activities**	**Business-type Activities**	**Total**	**Component Units**
Primary government:								
Governmental activities:								
General government	$ 9,571	$ 3,147	$ 843	$ -	$ (5,581)	$ -	$ (5,581)	-
Public safety	34,845	1,199	1,308	62	(32,276)	-	(32,276)	-
Public works	10,129	850	-	2,253	(7,026)	-	(7,026)	-
Engineering services	1,300	705	-	-	(595)	-	(595)	-
Health and sanitation	6,739	5,612	575	-	(552)	-	(552)	-
Cemetery	736	213	-	-	(523)	-	(523)	-
Culture and recreation	11,532	3,995	2,450	-	(5,087)	-	(5,087)	-
Community development	2,994	-	-	2,580	(414)	-	(414)	-
Education (payment to school district)	21,893	-	-	-	(21,893)	-	(21,893)	-
Interest on long-term debt	6,068	-	-	-	(6,068)	-	(6,068)	-
Total governmental activities	105,807	15,721	5,176	4,895	(80,015)	-	(80,015)	-
Business-type activities:								
Water	3,596	4,159	-	1,160	-	1,723	1,723	-
Sewer	4,913	7,171	-	486	-	2,744	2,744	-
Parking facilities	2,796	1,344	-	-	-	(1,452)	(1,452)	-
Total business-type activities	11,305	12,674	-	1,646	-	3,015	3,015	-
Total primary government	$ 117,112	$ 28,395	$ 5,176	$ 6,541	(80,015)	3,015	(77,000)	-
Component units:								
Landfill	$ 3,382	$ 3,858	$ -	$ 11	-	-	-	487
Public school system	31,186	706	3,937	-	-	-	-	(26,544)
Total component units	$ 34,568	$ 4,564	$ 3,937	$ 11	-	-	-	(26,056)
General revenues:								
Taxes:								
Property taxes, levied for general purposes					51,694	-	51,694	-
Property taxes, levied for debt service					4,726	-	4,726	-
Franchise taxes					4,056	-	4,056	-
Public service taxes					8,970	-	8,970	-
Payment from Sample City					-	-	-	21,893
Grants and contributions not restricted to specific programs					1,458	-	1,458	6,462
Investment earnings					1,958	601	2,559	882
Miscellaneous					885	105	990	22
Special item—Gain on sale of park land					2,653	-	2,653	-
Transfers					501	(501)	-	-
Total general revenues, special items, and transfers					76,901	205	77,106	29,259
Change in net assets					(3,114)	3,220	106	3,203
Net assets—beginning					126,673	82,349	209,022	16,026
Net assets—ending					$ 123,559	$ 85,569	$ 209,128	$ 19,229

Source: GASB No. 34, pp. 208-209, B-1
Prepared by J. Arellano, 5/23/06

Exhibit 5

United States Government
Reconciliations of Net Operating Cost and Unified Budget Deficit
For the Years Ended September 30, 2005, and September 30, 2004

(in billions of dollars)	2005	2004
Net Operating cost [actual accrued deficit]	(760)	(615)
Components of Net Operating Cost Not Part of the Budget Deficit:		
Increase in Liability for Military Employee Benefits:		
Increase in military pension liabilities	58	99
Increase in military health liabilities	109	42
Increase in other military benefits	3	2
Increase in liability for military employee benefits	170	143
Increase in Liability for Veterans Compensation and Burial Benefits:		
Increase/(decrease) in liabilities for veterans	150	(40)
Increase in liabilities for survivors	47	10
Increase in liabilities for burial benefits	1	0
Increase/(decrease) in liability for veteran's compensation	198	(30)
Increase in Liability for Civilian Employee Benefits		
Increase in civilian pension liabilities	43	40
Increase in civilian health liabilities	25	22
Increase/(decrease) in other civilian benefits	(6)	7
Increase in liability for civilian employee benefits	62	69
Decrease in Environmental Liabilities		
Increase/(decrease) in Energy's environmental liabilities	8	(2)
Increase in all others' environmental liabilities	2	1
Increase/(decrease) in environmental liabilities	10	(1)
Depreciation expense	80	90
Property, plant, and equipment disposals and revaluations	48	0
Increase in benefits due and payable	14	3
Increase in insurance programs	31	37
(Increase)/decrease in taxes receivable	(1)	2
(Increase) in accounts receivable	(9)	(1)
Increase in other liabilities	15	(5)
Seigniorage and sale of gold	(1)	(1)
Increase/(decrease) in accounts payable	8	(2)
Components of Budget Deficit Not Part of Net Operating Cost	—	—
Capitalized Fixed Assets:		
Department of Defense	(110)	(83)
Civilian agencies	(37)	(29)
Total capitalized fixed assets	(147)	(112)
Decrease/(increase) in inventory	(11)	(9)
Decrease/(increase) in securities and investments	(18)	-
Increase in other assets	(5)	(12)
Principal repayments of preceded reform loans	10	9
Net amount of all other differences	(13)	23
Unified budget deficit [actual cash deficit]	(319)	(412)

Exhibit 6

General Fund of Sample City
Budgetary Comparison Schedule For the Year Ended December 31, 2002

Dollar amounts in thousands	Budgeted Amounts: Original	Budgeted Amounts: Final	Actual Amounts (Budgetary Basis)	Variance with Final Budget Positive (Negative)
~~Budgetary~~ fund balance, January 1	$ 3,529	$ 2,743	$ 2,743	$ -
Resources (inflows):				
Property taxes	52,018	51,853	51,173	(680)
Franchise taxes	4,546	4,529	4,056	(473)
Public service taxes	8,295	8,307	8,970	663
Licenses and permits	2,127	2,127	2,288	161
Fines and forfeitures	719	719	607	(112)
Charges for services	12,393	11,202	11,374	172
Grants	6,906	6,571	6,120	(451)
Sale of land	1,355	3,500	3,477	(23)
Miscellaneous	3,024	1,221	882	(339)
Interest received	1,016	550	552	2
Transfers from other funds	939	130	129	(1)
Amounts available for appropriation	96,867	93,452	92,371	(1,081)
Charges to appropriations (outflows)				
General government:				
Legal	665	664	633	31
Mayor, legislative, city manager	3,059	3,193	2,658	535
Finance and accounting	1,932	1,913	1,853	60
City clerk and elections	346	354	341	13
Employee relations	1,315	1,300	1,234	66
Planning and economic development	1,976	1,784	1,643	142
Public safety:				
Police	19,577	20,368	20,246	121
Fire department	9,565	9,560	9,560	-
Emergency medical services	2,323	2,470	2,460	10
Inspections	1,586	1,586	1,533	52
Public works:				
Public works administration	388	385	383	2
Street maintenance	2,153	2,233	2,233	-
Street lighting	763	760	760	-
Traffic operations	386	375	361	14
Mechanical maintenance	1,526	1,273	1,256	17
Engineering services:				
Engineering administration	1,171	1,158	1,158	-
Geographical information system	126	139	139	-
Health and sanitation:				
Garbage pickup	5,756	6,175	6,175	-
Cemetery:				
Personal services	425	425	423	2
Purchases of goods and services	300	300	284	16
Culture and recreation:				
Library	985	1,023	1,022	1
Parks and recreation	9,521	9,786	9,757	30
Community communications	552	558	510	48
Nondepartmental:				
Miscellaneous	-	260	260	-
Contingency	2,544	-	-	-
Transfers to other funds	2,970	2,164	2,164	-
Funding for school district	22,000	22,000	21,893	107
Total charges to appropriations	93,910	92,206	90,939	1,267
Budgetary fund balance, December 31	$ 2,957	$ 1,246	$ 1,432	$ 186