

## **GOVERNMENT-WIDE FINANCIAL STATEMENTS OF AMERICAN STATE AND LOCAL GOVERNMENT**

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In *Statement No. 34* (issued in June 1999), the Governmental Accounting Standards Board (GASB) requires American state and local governments to produce a set of basic financial statements that include both government-wide financial statements and fund financial statements. In so doing, the board made the most far-reaching changes in these governments' financial reporting model, and at the same time retained the tradition of fund reporting. This paper explains the form and content of the government-wide financial statements.

### **1. Objectives of the Government-wide Financial Statements**

GASB requires state and local governments to produce two government-wide financial statements: a statement of net assets and a statement of activities (see Appendix). The board believes that these statements will help users:

- Assess the finances of the government in its entirety, including the year's operating results
- Determine whether the government's overall financial position improved or deteriorated
- Evaluate whether the government's current-year revenues were sufficient to pay for current-year services
- See the cost of providing services to its citizenry
- See how the government finances its programs – through use fees and other program revenues versus general tax revenues
- Understand the extent to which the government has invested in capital assets, including roads, bridges, and other infrastructure assets
- Make better comparisons between governments (*GASB Statement No. 34*, "Preface")

### **2. General Requirements**

Government-wide financial statements are intended to provide information about the overall government as a reporting entity, and required to distinguish between the primary government and its discretely presented component units in this entity (details in next section).

The government-wide financial statements exclude information about fiduciary activities, including component units such as some public employee retirement systems.

The reason is that when a government acts as a trustee or agent for others, it cannot use the principals' resources to finance its programs.

Government-wide financial statements are required to distinguish between the governmental activities and business-type activities of the primary government.

The government-wide statement of net assets has a **broad measurement focus**. Assets encompass all financial and economic resources, including infrastructure fixed assets. Both short-term and long-term liabilities are presented on the statement of net assets (see Exhibit 1).

The government-wide statement of activities uses the accrual basis of accounting. It is designed to show whether current operations have made government better off or worse off in terms of having more or less net assets.

Exhibit 1. Balance Sheet with Broad Measurement Focus.

<u>Assets</u>	<u>Liabilities</u>
<ul style="list-style-type: none"> <li>• Financial resources               <ul style="list-style-type: none"> <li>○ Current financial resources                   <ul style="list-style-type: none"> <li>▪ Monetary assets</li> <li>▪ Financial investments</li> <li>▪ Receivables</li> <li>▪ Inventories for sale</li> </ul> </li> <li>○ Long-term financial resources                   <ul style="list-style-type: none"> <li>▪ Financial investments</li> <li>▪ Receivables</li> </ul> </li> </ul> </li> <li>• Non-financial resources               <ul style="list-style-type: none"> <li>○ Inventories for use</li> <li>○ Cultural and historical treasures</li> <li>○ Capital assets                   <ul style="list-style-type: none"> <li>▪ Equipment and similar</li> <li>▪ Buildings</li> <li>▪ Infrastructure</li> <li>▪ Land</li> </ul> </li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Current liabilities</li> <li>• Long-term liabilities               <ul style="list-style-type: none"> <li>○ Debt related to capital assets</li> <li>○ Bonds, notes</li> <li>○ Operating debts, e.g. pension payable</li> </ul> </li> </ul>
	<u>Net Assets</u>
	<ul style="list-style-type: none"> <li>• Net assets invested in capital assets, net of related debt</li> <li>• Net assets restricted for...               <ul style="list-style-type: none"> <li>○ Capital projects</li> <li>○ Debt service</li> <li>○ other purposes</li> </ul> </li> <li>• Unrestricted net assets               <ul style="list-style-type: none"> <li>○ Designated</li> <li>○ Undesignated</li> </ul> </li> </ul>

### 3. Reporting Entity

Government-wide financial statements are required to include the **primary government** and its **component units** in the reporting entity. The primary government is the focus of the government-wide financial statements. A total column is presented for the primary government. A total column for the entire reporting entity is optional.

A primary government is a state government or a general-purpose (i.e. multiple service function) local government. A primary government usually has a high degree of autonomy and members of its legislature are always elected. A special district (i.e. single service function local government) can also be a primary government if it is legally independent, has a separately elected governing board, and has a high degree of fiscal autonomy.

Even though component units (CU) are legally separate organizations, the primary government (PG) may be **financially accountable** for them. The financial accountability

may derive from the power of the PG to appoint a majority of the governing board of the component unit, and either: (a) the PG can impose its will on the CU (e.g. to approve or disapprove its budget) or (b) the CU can benefit or burden the PG. If the relationship between a CU and the PG is so close that the CU is virtually a part of the PG, the CU's financial statements should be **blended** (i.e. merged) with those of the PG. Otherwise, the CU's financial statements are **discretely** (i.e. separately) presented alongside with the PG's.

#### 4. Governmental and Business-Type Activities

Governmental activities and business-type activities are distinguished in the government-wide financial statements. Taxes, intergovernmental grants and other non-exchange revenues finance **governmental activities**, which produce public goods to benefit the citizenry at large. User fees are the primary sources of revenue of **business-type activities**, which produce individually consumed goods or services.

Business-type activities are characterized by the exchange relationship between the government as a seller and the public as buyers of identifiable and divisible goods or services. Some business-type activities in government are expected to be self-sufficient like their private-sector counterparts, while others are subsidized by taxes like governmental activities. The GASB believes that the full cost of service (including the cost of using capital assets) is useful for public policy decisions on how much to subsidize them, if any. It is also important to recognize that, similar to governmental activities, government business-type activities are subject to the public accountability requirements.

Due to the public goods nature of their services, governmental activities tend to be financed primarily by taxes. Unlike business-type activities, the matching of cost of service and revenue is difficult or impossible at the individual level, and often unnecessary. The ability to pay is a secondary criterion for their allocation; indeed, the public is often a passive or even reluctant recipient of service (e.g. a traffic violation citation). Therefore, governmental activities are characterized by non-exchange relationships on both the output side and input side. Their production is financed by budget allocations determined through the political process.

Together governmental activities and business-type activities influence a government's financial position and performance detailed in financial statements.

#### 5. Statement of Net Assets

GASB *Statement No. 34* requires that **the statement of net assets** to have a broad measurement focus. That is, it **reports all financial and capital resources**, and all liabilities regardless of whether they are short-term or long-term.

Capital assets are reported at historical cost. Capital assets include: land, improvements to land, easements, building, building improvements, vehicles, machinery, equipment, work of arts and historical treasures, infrastructure, and all other tangible and intangible assets with useful lives longer than one year.

Infrastructure assets are normally stationary and, if maintained well, they can have very long useful lives. Examples include: roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems.

Generally, capital assets are depreciated over their estimated useful lives. Exceptions are those assets that are inexhaustible (e.g. land and land improvements), or are infrastructure that are reported using the modified approach (described below). GASB does not prescribe any particular depreciation methods, other than requiring systematic and rational allocation of net cost.

Infrastructure assets that are part of a network are not required to be depreciated if they are managed and preserved at or above the officially established (physical) condition level. GASB has detailed requirements of this “alternative approach.” The basic idea that capital expenditures made to keep infrastructure assets in good working conditions are treated as expense; however, expenditures that add or improve them should be capitalized.

The capitalized requirements for works of art and historical treasures are similar to those of FASB *Statement No. 117*.

GASB encourages governments to present a government’s financial position as: assets less liabilities equal **net assets** (not fund balance or equity). Assets and liabilities are presented in order of their relative liquidity: nearness to cash for assets, and maturity dates for liabilities. As Exhibit 1 shows, net assets are displayed in three components:

- **Net assets invested in capital assets, net of related debt,**
- **Restricted net assets,** and
- **Unrestricted net assets.**

In effect, restricted net assets and unrestricted net assets add up to the government’s net *financial* assets. Restrictions result from constraints imposed by creditors, grantors or high-level governments, as well as by law (e.g. constitutional provisions or legislations) directing specific purposes for certain resources.

## **6. Statement of Activities**

GASB Statement No. 34 requires that a strong accrual basis be used in measuring expenses and revenues for reporting periodic financial performance in a statement of activities. Expenses include not only the use of financial and capital assets, but also increases in short-term and long-term liabilities incurred for rendering service. Legally enforceable claim is the basis for recognizing revenues from non-exchange transaction, and service efforts and accomplishment is the basis for recognizing sales revenue. Because of this long-term orientation, the GASB believe that the accrual basis can promote **interperiod equity**. Interperiod equity reflects the value judgment that people who receive services should pay for them, rather than shifting them to another period for others to finance them. The implementation of this notion will be discussed in greater detail in the next section.

The expenses of providing services through governmental activities and business-type activities are detailed in the Statement of Activities. Exhibit 11.2 shows the net expense or revenue format of reporting a government’s financial performance during a period. That is, the expense of each service function is offset by a combination of fees, grants and contributions (collectively called **program revenues**) that are associated with that service function. Expenses include at least direct expenses, but may also include a service function’s share of indirect expenses. If the expense is greater than the program

revenues, the difference is called **net expense**; if the expense is less than the program revenues, the difference is called **net revenue**.

This format is intended to highlight the relative financial burden each service function imposes on taxpayers. As would be expected, governmental activities usually have net expenses, while business-type activities can have net expenses, net revenue or breakeven. In the aggregate, net expenses are to be financed by **general revenues** from taxes and other sources that are not dedicated to specific service functions. It is important to distinguish between program revenues and general revenues (Exhibit 2).

In the final analysis, if total expenses exceeded total revenues, net assets would decrease during the period; if total revenues exceeded total expenses, net assets would increase during the period. In this way, the statement of activities is articulated with the statement of net assets.

Exhibit 2. Program Revenue and General Revenue.

Financing Sources	Revenue Classification
Those who purchase, use, or directly benefit from the goods or services of the program	Always a program revenue
Parties outside of the reporting government's citizenry	Program revenue if restricted to a specific program or programs; if unrestricted, general revenue
The reporting government's taxpayers regardless of benefits received	Always general revenue, even if restricted to a specific program
The reporting government itself (e.g. investment income)	Usually a general revenue

## 7. Summary

Government-wide statements are designed to evaluate the whole government's financial condition. The comparative statements of net assets and the statement of activities can be used to determine whether the government's overall financial position improved or deteriorated between two year-ends. The statement of activities shows whether the government's current-year revenues were sufficient to cover the expenses of current-year services to the citizenry. By means of the net expense/revenue format, the statement of activities shows the extent to which government services are financed by fees, and restricted grants and contributions, or by general tax revenues. It is noteworthy that the statement of net assets reports investment in capital assets, including infrastructure assets. With some exception, depreciation expense is calculated and included in the expense of service, and capital assets are reported at their historical cost net of accumulated depreciation..