

Chapter 1 Introduction and Overview

Objectives, Significance and Scope

Objectives

The objective of this monograph is present the essence of American government accounting standards to an international audience, especially Chinese researchers, scholars and students. They have only a limited amount of time and usually, initially anyway, wish to acquire only an overview of American government accounting. Unfortunately, because of the institutional arrangements in the United States, there does not exist a body of American government accounting standards as such. There are two separate sets of standards: one for the Federal Government and another for state and local governments. From an international perspective, their similarities are of greater interest than their differences. However, American government accounting researchers tend to focus on specific aspects, and practitioners focus on their job responsibilities. American professors teach and students learn government accounting primarily for CPA examination preparation. Currently the CPA examination does not even cover Federal Government accounting. Thus the minimal objective of monograph is to at least introduce both these two bodies of standards, so that the reader can identify the major features of American government accounting. It is beyond the objective of this monograph and the capacity of the author to “harmonize” the two sets of standards. But an effort will be made to formulate a tentative set of principles, because the author, for one, has found it almost impossible to remember the titles of the eighty standards, let alone their specific provisions.

This monograph is written to make it easier for the United States to be included in comparative international government accounting research (CIGAR). This line of research is primarily interested in *international* similarities and differences. Intra-country differences are either assumed to be very insignificant or ignored. In the absence of a systematic analysis, it is difficult to say whether the differences between Federal and state/local governments are significant or not. Perhaps it depends on the observer’s perspective. An American may find large differences between Federal and state/local government standards, because he/she is observing them up close. The same differences, observed from afar by a Chinese, for example, may be relatively minor. In any event, whenever intra-country homogeneity cannot be assumed, domestic comparative study is needed for constructing a “country case study” for international comparison.

The third objective of writing this monograph is to help determine the relevancy of American government accounting standards to China’s government accounting reform. Obviously, the Chinese Government has no obligation whatsoever to apply American government accounting standards. However, Chinese researchers in government and in universities have invested an enormous amount of time and energy translating American government accounting textbooks, standards and financial statements. Intellectual curiosity is always an admirable trait, and international understanding is always worth promoting. Nevertheless, for the research to have practical payoff, one has to answer the question: what aspects of American government accounting is transferable to China?

This is an irresistible question for a Chinese who has spent his entire career studying American government accounting. This monograph is the result of a personal and professional project to see what aspects of American government accounting can be transplanted to China. When one considers that the Federal Government does not use state/local government accounting standards, and vice versa, it is all the more remarkable to see the level of Chinese interest in American government accounting.

Significance

If anyone wants to know government accounting in the United States, there does not exist anywhere a one-volume reference. It is true that both the [State and Local] Governmental Accounting Standards Board (GASB) and the Federal Accounting Standards Advisory Board (FASAB) have published voluminous documents containing their standards. However, their sheer volume and technical complexity make them inaccessible to researchers and practitioners in other countries. To the author's knowledge, this monograph is the first to comprehensively and concisely communicate American government accounting standards to an international audience, especially readers in China.

The monograph is not a condensation of the GASB and FASAB standards. That would be impossible and unnecessary. Rather, it attempts to explain the rationale and structure of the standards. This is done for GASB and FASAB standards separately, as they are two distinct sets of standards. The institutional structure and standard setting process will also be described. Then the author will attempt to present American government standards by emphasizing the commonalities between the standards set by these two boards. It is somewhat understandable that, given the boards' separate jurisdictions, they apparently see little urgency to harmonize their standards. This posture is hardly exemplary when the world-wide accounting profession has been promoting common government accounting on a global basis.

Scope

This monograph covers contemporary American government accounting standards, specifically Generally Accepted Accounting Principles (GAAP) promulgated by the GASB and FASAB. The GASB produced almost fifty standards during the period from 1984 to 2006; the FASAB produced over thirty standards during the period from 1991 to 2006. Independent Certified Public Accountants (CPAs) as external auditors of American governments use these principles to assess the fairness of financial presentation of American governments for the purpose of expressing an audit opinion. The GASB and FASAB have also produced additional documents such as technical bulletins and implementation guides, and "due process" documents such as exposure drafts and preliminary drafts. These documents are of secondary importance for the purpose of the monograph and are not covered in this monograph. However, since the standards are guided by the boards' conceptual frameworks, their statements of concepts will be included in this study.

It is beyond the scope of the monograph to discuss the rules and regulations issued by the chief budget, accounting or auditing officials of Federal Government and the fifty state governments, or the 87,000 large and small local governments. However, the relationship between GAAP and government rules and regulations will be explained.

Why Study American Government Accounting?

Reasons for Studying American Government Accounting

If the International Federation of Accountants (IFAC) was audacious enough to think that a group of accountants from a few countries could, with the financial backing of major international financial institutions, produce International Public Sector Accounting Standards for global use, perhaps the author has underestimated the universality of American government accounting ideas. Whereas IPSAS, so far any way, is basically a slight modification of international business accounting standards, American government accounting standards have benefited from a serious and critical examination of the differences between business and government. American government accounting represents the “moderate” model of Western government accounting. It is neither as traditional as some Western European countries (e.g. Germany, and France until the current reform), nor as radical as the advanced English-speaking countries (such as Australia, New Zealand and Great Britain).

Another reason for studying the American experience is that over the last thirty years, the two government accounting standards boards in the United States have produced a substantial body of standards to deal with a large number of accounting and financial reporting issues unique to the public sector. While a fair number of the issues are unique to American governments, many of them deal with core public sector issues that exist anywhere.

Finally, the United States has a long history of reforming government accounting during the 20th century. The American experience shows that government accounting reform is not an isolated technical exercise, but is part of nation-building, of aligning the role of government with its social, economic and political environment. Thus the American “country case study” has many facets and periods, each offering some interesting lessons. The American reform experience predates and has become a part of what has been called a “revolution” in government accounting.

Revolution in Government Accounting?

The so-called government accounting revolution refers to demanding governments to produce consolidated financial statements on the accrual basis, similar to what modern corporations have been doing for decades. Until recent corporate accounting scandals in the United States, business accounting had been held as a role model for government accounting for promoting accountability and transparency. Corporate managers demonstrate their accountability to investors by giving them financial overviews that meet accounting standards set by an independent body. Likewise, reformers believe that public officials should also demonstrate their

accountability to taxpayers by giving them understandable financial reports according to rules set by an independent body.

As will be detailed in the next chapter, these reformers were leading private-sector accounting firms, government officials and academics in the 1970's in the United States. The fervor for improving government accounting then spread to Canada, Australia and New Zealand in the 1980s, and to the United Kingdom in the 1990's. Under the influence of ideas and advisors from these countries, international organizations such as the World Bank, International Monetary Fund (IMF) and United Nations Development Program (UNDP) began to recommend this Anglo-American model for developing countries and Eastern European countries transitioning to a market economy. During the past decade, this model has spread to Western Europe, with France, perhaps surprisingly, embracing the spirit of this new brand of government accounting.

Why did this "revolution" occur?

Elements of Modern Government Accounting

The budget is the primary, if not the only, document Western governments use to inform the public about government finances. A government budget shows the government's priorities and provides as basis for raising revenues, and borrowing to finance deficits, if any. Government accounting reformers believe the cash budget is necessary but insufficient. A cash budget does not show the costs (e.g. employee pensions) postponed to the future for payment. Besides, a budget is a declaration of intentions. Are the promises made in a budget kept? Year-end financial statements based on facts became recognized as another tool to enforce fiscal discipline and accountability in recent decades. This coincided with major political and economic restructuring in many countries.

The winds of democracy and market economy sweeping the globe during the last two decades have encouraged government accountability and transparency. These two values are the foundation for the practice of accounting and auditing in the public sector. Even when it is narrowly and condescendingly regarded as glorified bookkeeping, accounting can still contribute to government fiscal accountability by requiring accurate financial recordkeeping of public money received and spent by government. The creation and preservation of such audit trails could deter corruption and graft.

The modern practice of government accounting is much more than financial recordkeeping. It can facilitate sound financial management by making sure that the budget is faithfully and efficiently executed through authorized transactions and effective government actions. In particular, financial accounting in government is the systematic process of identifying, recognizing, and measuring the financial consequences of these government transactions and actions. Up to this point, accounting, even at its best, is only an adjunct to administration: the information lies inside government. As such, the information helps the government manage its financial affairs, but it does not help stakeholders hold government accountable. Stakeholder groups include legislators and regulators; voters, taxpayers and the general public; creditors and investors in government securities; employees and vendors; and grantors and donors. All these

stakeholders provide economic and political resources to government, thereby acquiring the right or need to know its finances.

The contemporary interpretation of the scope of accounting extends to financial reporting, especially to those who have the political right to know and economic need to know and yet lack the authority and resources to demand information. Accounting thus has become both a product and an enforcement mechanism of democratic accountability in the political system and of economic reciprocity in a market economy. These are the values championed by Western democracies, and by the international institutions they support and dominate especially in the post-Cold War era. No matter how imperfect democracy is and how poorly the market economy work in a particular country, as ideals they have inspired what has been called “a global revolution in government accounting.”

The revolutionary thinking in government accounting has several key elements. (1) Governments should issue audited financial reports shortly after the end of a fiscal year. Most governments prepare budgets, but not all prepare and make public financial reports derived from their accounting systems to serve as a factual check on the budget. (2) Financial reports should not be limited to cash receipts and disbursements, but should report the government’s economic resources and short- and long-term liabilities. This would be a major departure from the traditional cash budget. (3) Government accounting and reporting rules should be set by independent bodies and not by governments themselves. Year-end financial reporting on the government as a whole on the accrual basis in accordance with generally accepted accounting principles (GAAP) is required of public sector institutions in the United States and developed countries in the British Commonwealth. The “global” dimension of the revolution reflects the influence of these countries on the international and financial institutions that provide financial and technical assistance to developing countries and those in transition to a market economy.

An Overview of Contents

Besides this introductory chapter, this monograph consists of six substantive chapters. Chapters 2, 3 and 4 describe the American environment, and the historical and institutional context of government accounting standard setting. As the technical core of the book, Chapter 5 and 6 discuss the structure and contents of GASB and FASAB standards, and the current developments and current issues. The last chapter explores the relevancy of American government accounting to the current reform effort underway in China.

The first part of Chapter 2 identifies the characteristics of the American economy and political system, including the structure and function of American government. The author’s hypothesis is that accounting is shaped by its environment more so than the other way around. The second part addresses the issue of theoretical foundation of government accounting. It is proposed that government accounting researchers take advantage of some political scientists’ vision of government as an adaptive system. In particular, Herbert Simon’s organization theory appears to be a remarkably accurate description of how American governments behave. The theory is renamed a stakeholder theory of government, and its implications for government accounting are drawn.

Chapter 3 describes how American government accounting evolved during the 20th Century. While early progressive reform ideas affected government at all levels, the Federal Government focused on budgeting, and state and local governments on accounting. Concerning state and local government accounting reforms, three stages or “waves” of reform were discernible: ensuring financial integrity in the first two decades; supporting law-based financial management from the 1930’s to the mid-1970’s, and promoting accountability to the public and transparency since the municipal financial crises in the 1970s up to the present time. Federal government accounting reform was beset with institutional and conceptual issues. It was not until 1990 that the institutional issues were resolved so that technical standard setting activities could begin. This chapter therefore provides the historical context that is necessary for understanding what follows in subsequent chapters.

Chapter 4 covers the standard-setting institutions, their “due process” procedures and their products. Given their different backgrounds, it is necessary to discuss the Federal Accounting Standards Advisory Board (FASAB) and the Governmental Accounting Standards Board (GASB) separately. However, in both cases, the description will cover: their mission, domain and authority, resource Support, standard-setting and related activities, and the outputs of those activities. An inventory of the statements of concepts and statements of standards is provided in two appendices of this chapter. Anticipating the organizational survival problem that these boards face (or potentially face all the time), this chapter uses the stakeholder theory of Chapter 2 to answer the question: who cares about GASB or FASAB?

Whereas the list of standards following Chapter 4 merely identifies the standards, Chapter 5 tries to see their structure. In other words, is there a pattern among the GASB standards? Is there a pattern among the FASAB standards? Do these two sets of standards follow the same pattern? After failing to sort the GASB and FASAB into a pre-conceived pattern, the author gave up and decided to let the standards form their own patterns. It will be seen that most FASAB standards cluster around specific accounting and reporting issues: e.g. specific assets, liabilities, social insurance, and Consolidated Financial Report. GASB standards are more easily classified as general standards and specific standards.

In another attempt to generalize the standards regardless of their institutional origin (i.e. GASB or FASAB), the author suggests the concept of an “accounting policy space,” which can be thought of as a menu of accounting choices. The dimensions of the accounting policy space are delineated (e.g. reporting entity, basis of accounting) and the potential alternatives along each dimension are identified (e.g. cash basis and accrual basis along the “basis of accounting” dimension). In this way, the decisions of the GASB and FASAB can be seen as choosing from the available alternatives. These dimensions also give us a way to characterize American government accounting standards in general. At the risk of over-generalization, the GASB and FASAB standards are distilled as ten principles.

Both the GASB and FASAB have passed their formative years, and may even experienced two rotations of members. Chapter 6 provides updates about current developments at these boards. It is interesting that both the GASB and FASAB have been engaged in some strategic thinking about their institutional priorities and futures, and have re-resumed research on conceptual framework. Both boards face organizational

problems, but of different kinds: at the FASAB, it is the independence of the board from its sponsors; at the GASB, it is the chronic uncertainty of adequate funding. Besides, there are numerous substantive issues. These are identified toward the end of Chapter 6.

Unlike the previous chapters, the last chapter is rather subjective in nature. It addresses the relevance of American government accounting standards to China's current reform effort. After remarking on the costs and benefits of government accounting reform, this chapter points out some positive lessons and negative lessons from the American experience of setting government accounting standards. The positive lessons are worth emulating, while the negative lessons are to be avoided. The chapter concludes with the author's recommendations about increasing the probability of success in reorienting China's budget-based cash accounting system to one that can serve the multiple functions of ensuring financial integrity, supporting financial management, and demonstrating public accountability through greater financial disclosure.

REFERENCES AND FURTHER READINGS

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