Chapter 5
The Structure of American Government Accounting Standards

INTRODUCTION

Whereas Chapter 4 focused on the organizational and process aspects of American government accounting standard setting, this chapter will pay exclusive attention to the GASB and FASAB standards that emerge from their deliberative processes. While the boards carefully distinguish between "concepts" and "standards," both are discussed in this chapter because of their close relationships.

FASAB standards are discussed first, followed by the GASB standards. The different formats of these two sections are due to the way each board's standards form clusters. The different clusters and their contents suggest the "structure" of each board's standards. Then, a government accounting policy space with ten dimensions or aspects is proposed for organizing the numerous standards. Finally, a tentative set of ten principles is offered as a summary of .American government accounting standards.

THE STRUCTURE OF FASAB STANDARDS

Introduction

Since its establishment in late 1990 to the end of 2006, the Federal Accounting Standards Advisory Board (FASAB) has produced four Statements of Federal Financial Accounting Concepts (SFFAC) and thirty-one Statements of Federal Financial Accounting Standards (SFFAS). As the boundary between "Concepts" and "Standards" are rather blurred, both sets of statements are discussed below, and are referred to as FASAB Concepts and FASAB Standards.

It is not easy to discern a structure or pattern in the thirty plus FASAB Standards. They are grouped in several clusters based on elements in the financial statements: assets and liabilities, revenues and expenses. Two more clusters of standards focus on social insurance and stewardship information. After these four clusters are extracted, the rest of the FASAB do not seem to coalesce. Several standards relate to cost accounting, which falls outside the boundary of financial accounting and hints at the FASAB's reluctance to refrain from setting cost accounting standards.

Statement of Federal Financial Accounting Concepts

In FASAB *Concepts No. 1* on the objectives of Federal financial reporting, the FASAB expresses the belief that Federal accounting systems should be capable of producing information for legal and budgetary compliance and financial reporting according to GAAP. FASAB *Concepts No. 2* on entity and display sets forth general principles on the reporting entity and the form and content of financial statements. It addresses one of the early issues in standard setting of whether there should be two sets of accounting and financial reporting standards: one for the entire government and another for government agencies. This Concepts statement is based on the premise that there should only be one set of standards for the Federal Government, with the agencies considered as its component units. The Federal reporting entity is based on the scope or coverage the unified Federal budget, which aims to include all Federal entities, programs and activities. Agency financial statements should report on the status and use of budgetary resources, in addition to financial position and performance based on actual transactions and events.

The FASAB Concepts series did not address many conceptual issues facing Federal accounting. Instead, the next two Concepts statements deal with the topic of better financial communication. *Concepts No. 3* on Management's Discussion and Analysis (MD&A) requires information about the reporting entity's mission and structure, actions and plans, internal control, and events affecting the entity's future, I addition to financial highlights. *Concepts No. 4* indicates that the Consolidated Financial Report (CFR) of the United States Government is intended primarily for citizens and their intermediaries, members of Congress, as well as executive officials and program managers.

FASAB Standards on Assets and Liabilities

Financial Assets. In *Standards No. 1* (issued in 1993) the FASAB attempted to formulate the concept of net financial resources by discussing nearly ten balance sheet items that are classified as current financial resources and current liabilities. This standard distinguishes between assets and liabilities at the government and entity level, and requires the separate classification of intra-governmental assets and liabilities.

In order to provide timely accounting guidance to accompany the newly passed Federal Credit Reform Act of 1990, FASAB *Standards No. 2* (issued in 1993) addressed direct loans and loan guarantees. Consistent with the Act, this statement requires that direct loans and loan guarantees committed after the end of fiscal year 1991 be accounted for on a present-value basis. A subsidy expense is recognized for direct or guaranteed loans disbursed in a fiscal year. FASAB Standard *No. 18* (issued in 2000) amended No. 2 to requires re-estimates of subsidy expense be separated into interest rate and default components, and a reconciliation of subsidy cost allowances. Additional disclosures about program characteristics and performance are also required. Shortly thereafter, FASAB *Standards No. 19* made further technical amendments to No. 2 and No. 18. It clarifies the cash flow discount method, interest rate adjustment and default cost calculation; the standard also rescinds the reconciliation of subsidy cost allowances.

Non-financial Assets. The FASAB spent considerable time and effort dealing with the accounting and reporting of non-financial assets. *Standards No. 3* deals with inventory and related property, and endorses historical cost or market value for measuring each class of assets. Several FASAB standards have tried to clarify the accounting and reporting of capital assets:

Standards No. 6 (issued in 1995) on "Property, Plant & Equipment (PP&E)" classifies these as: general PP&E, Federal mission PP&E, heritage assets, and stewardship land. The acquisition costs of general PP&E should be capitalized and depreciated, while those of other types of PP&E should be treated as expense. *Standards No. 14* (issued in 1999) "Amendment to Deferred Maintenance Reporting" amends Standards No. 6 and defines deferred maintenance as required supplemental information, instead of being a line in the statement of net cost with reference to note disclosure. *Standards No. 11* (issued in 1998) amended the PPE definitions and eliminated the category of Federal mission PP&E and instead created a new category for national defense PP&E. Four years later, *Standards No. 23* (issued in 2003) eliminated the national PP&E and reclassifies it as general PP&E subject to requirements of capitalization and depreciation.

By virtue of FASAB *Standards No. 16* (issued in 1999), multi-use heritage assets are defined as predominantly for general government operations, and therefore subject to capitalization and depreciation. Also, *Standards No. 10* (issued in 1998) requires the recognition of software used by a Federal agency to operate its programs or produce goods and services as general PP&E.

Liability. The main FASAB standards on Federal Government liabilities is *Statement No. 5* (issued in 1995). The standard requires the recognition of liability arising from both transactions and events. A Federal entity incurs a liability for goods or services received. It is also liable for the amount due under the terms of non-reciprocal transactions. A Federal entity can also incur liability in connection with events it has caused ("government-related events"), or for which it has voluntarily undertaken financial obligation ("government-acknowledged events"). This standard requires the recognition of contingent liability when the loss is more likely than not to occur. Later FASAB *Standards No. 12* (issued in 1999) creates an exception for contingency liabilities from litigation by requiring recognition when loss contingencies are likely to occur.

FASAB Standards on Revenues and Expenses

FASAB *Standards No. 7* (issued in 1996) is the major source of guidance regarding accounting for revenues and other financing sources. The standards requires Federal entities to recognize revenues to the extent it has provided goods and services. The standard acknowledges what it calls "inherent and practical limitations" in accruing revenues from nonreciprocal transactions (mainly taxes), and permits these revenues to be recognized on a modified cash basis. In agency financial accounting, budgetary resources from appropriations become a financing source when they are used to acquire goods and services, and the unexpended appropriation is the agency's capital. Agency financial statements are also required to provide a reconciliation between its net cost of operations and the budgetary obligations and non-budgetary resources available.

FASAB *Standard No. 27* focuses on revenue collections dedicated to specific purposes, the so-called "earmarked funds". This standard requires the separate disclosure of earmarked funds in the relevant financial statements.

A number of Federal agencies collect revenues on behalf of the Federal Government. FASAB *Standard No. 7* (issued in 1996) requires these agencies to make comprehensive disclosures about those transactions. Later *Standard No. 13* (issued in 1999) defers the effective date of that provision to FY 2001. Eventually FASAB *Standards No. 20* (issued in 2001) rescinds the SFFAS No. 7 requirement that revenue collection agencies of the Federal Government make comprehensive disclosures about these significant revenue related transactions.

Social Insurance

The treatment of social insurance programs is probably the most important and controversial issue in Federal accounting and financial reporting. Currently, under FASAB *Standards No. 17* (issued in 1999), the Federal Government recognizes liability for payments due and payable to beneficiaries or service providers of Federal social insurance programs. In order to help user assess the sustainability and sufficiency of social insurance programs, information on long-term projections of cash flow, the ratio of contributors to beneficiaries and the actuarial present value of future benefits and revenues is included in the required supplementary stewardship information (RSSI) section.

FASAB *Standards No. 25* (issued 2003) reclassifies stewardship responsibilities, dropping the Current Services Assessment and adding the risk assumed by the Federal Government in the Required Supplementary Stewardship Information (RSSI) section. The standard also announces that a Statement of Social Insurance will become a basic financial statement. Afterwards, *Standards No. 26* (issued in 2004) requires assumptions underlying the Statement of Social Insurance be disclosed in notes or narrative as an integral part of the statement. S*tandards No. 28* (issued in 2005) deferred the effective date of Statement of Social Insurance to the fiscal year 2006.

Budgetary Reconciliation

The FASAB is precluded by its charter from setting Federal budgeting standards. However, budgetary reconciliation in financial statements is necessary to enable users to see the relationship between the budgetary basis and accrual basis of accounting. The second part of *Standards No. 7* (issued in 1996) requires agency financial statements to provide a reconciliation between net operating cost and the agency's budgetary obligations and non-budgetary resources. In particular, this standard requires that increases and decreases in accounts receivable be reported as a non-budgetary resource. *Standards No. 22* (issued in 2001) deletes that requirement and no longer specifies the location of this item.

Consolidated Financial Report

Standards No. 24 (issued in 2003) makes all the Statements of Federal Financial Accounting Standards applicable to the Consolidated Financial Report (CFR) of the United States Government, except the requirements for budgetary resources and reconciling net cost with budget obligations. The CFR alone is required to include a reconciliation between net operating cost and deficit on the cash basis. FASAB *Standards No. 32* (issued in 2006) revised standards issued prior to *Standards No. 24* (issued in January 2003) so that the CFR would be accessible to the audience indicated in *Concepts No. 4*.

FASAB Standards on Financial Disclosures

Management's Discussion and Analysis. FASAB *Standards No. 15* (issued in 1999) makes the Management's Discussion and Analysis (MD&A) a type of required supplementary information (RSI), and affirms its content as described in *Concepts No. 3*.

Stewardship Information. The FASAB's thinking and standards regarding the off-balance sheet resources and responsibilities have been evolving:

Standards No. 8 (issued 1996) defines stewardship assets as: (1) stewardship property, plant, and equipment (PP&E), consisting of heritage assets, Federal mission PP&E, and stewardship land; (2) stewardship investments in non-Federal physical property, in human capital, and research and development. Stewardship responsibilities are equated with Current Services Assessment, which is the cost of the Federal Government's programs under existing laws . All the above information is presented as "required supplemental stewardship information" (RSSI) in the annual financial report. *Standards No. 11* (issued in 1998) amends *Standard No. 8* by eliminating the category of "Federal mission PP&E" and creates the new category "national defense PP&E" consisting mostly of PP&E of the Department of Defense. Eventually *Standards No. 23* (issued in 2003) reclassifies national defense PP&E as general PP&E beginning in the FY 2003.

S*tandards No. 16* (issued in 1999) requires heritage assets whose dominant use is general government operations ("multi-use heritage assets") be treated as general property, plant, and equipment. S*tandard No. 29* (issued in 2005) requires heritage assets and stewardship land be referenced in both the government-wide and agency balance sheets for description, without dollar amounts, in the notes to the financial statements. The condition of these resources is required supplemental information. The provisions of this standard become effective after the end of Fiscal Year 2007.

FASAB *Standards No. 31* (issued in 2006) requires financial statements of all Federal reporting entities to include a note on any fiduciary relationship with non-Federal parties, and schedules of fiduciary activity and net assets. The Consolidated Financial Report is also required to list component units with fiduciary activities and the amounts of their fiduciary net assets.

Cost Accounting

FASAB *Standards No. 4* (issued in 1995) requires full costs be accumulated for Federal programs and activities and prescribes procedures for handling inter-entity costs so that costs are attributed to responsibility segments. Later *Standards No. 9* (1997) deferred the implementation date for *Standard No. 4*. More recently, FASAB issued *Standards No. 30* (issued in 2005) to require a Federal entity's full cost to include the full cost of goods and services it receives from other Federal entities.

Others

Finally, FASAB *Standards No. 21* (issued in 2001) states that prior period financial statements should be corrected for material errors that are subsequently discovered, but should not be restated for changes in accounting principles.

Concluding Remarks

This section has presented FASAB's Statements of Federal Financial Accounting Concepts and Standards in several clusters of related standards. These standards reflect the FASAB's continued efforts to refine the recognition, measurement and disclosure of elements of financial statements. FASAB has also shown a tendency to bring more stewardship assets onto the balance sheets, and to reduce the information in the stewardship responsibilities section. The new statement of social insurance is a major step in this direction.

THE STRUCTURE OF GASB STANDARDS

Introduction

The GASB's standards may be into two groups: general standards and specific standards. The general standards set forth guiding principles, which in many cases have to be elaborated by additional standards. The general standards cover topics including: the financial reporting model, accounting and reporting entity, elements of financial statements and related recognition and measurement criteria, and the relationship between financial accounting and budgeting. The specific standards apply the general standards to deal with specific entities or activities, transactions, or elements of financial statements. GASB standards are influenced by ideas set forth in *Statements of Concepts*.

Statements of Concepts

The GASB issued three concepts statements. According to *Concepts No. 1* (issued in 1987), the objectives of government financial reporting are to: (1) demonstrate and assess government accountability, (2) evaluate results of government operations, and (3) assess government's ability to provide service. These objectives are derived from the information needs of three primary user groups: the citizenry, legislative and oversight bodies, and investors and creditors. The objectives also take into account the environment of government, as well as the nature of governmental and business activities.

GASB *Concepts No. 2* (issued in 1994) proposed to include service efforts and accomplishments (SEA) information in general purpose external financial reports in order to help users better assess a government's service. Such information ranges from indicators of inputs to those of outputs and outcomes, as well indicators that relate them. Reservations about the feasibility of SEA reporting and whether it should be included in financial reporting have delayed actions to incorporate SEA in GASB standards.

After a pause of ten years after the second Concepts statement, the GASB resumed work on a conceptual framework and issued *Concepts No. 3* (issued in 2005). This statement clarifies the relationships among several communication methods in general purpose external financial reports: the financial statements, notes to financial statements, supporting information (including required and other supplementary information). The statement also offers guidance in the selection of these communication methods.

As of the end of 2006, the GASB is also working on another statement of concepts related to elements of financial statements. Proposing some new concepts on resources. The elements of a statement of financial position are: assets, liabilities, a deferred outflow of resources, a deferred inflow of resources, and net assets. The elements of the resource flows statements include an outflow of resources, and an inflow of resources.

General Standards

NCGA Statement No. 1. NCGA *Statement No. 1* (issued in 1979) was entitled "Governmental Accounting and Financial Reporting Principles." It was an attempt to conceptualize the many provisions in the 1968 *Government Accounting, Auditing and Financial Reporting* publication. GASB *Statement No. 1* recognized the continued effectiveness of NCGA *Statement No. 1*, making it the starting points for the GASB's standard setting process. The Statement is sufficiently concise that it is possible to reproduce all the twelve principles here (Exhibit 5.1).

Exhibit 5.1
NCGA Statement 1 Principles

Accounting and Reporting Capabilities

1. A governmental accounting system must make it possible both: (a) to present fairly and with full disclosure the financial position and results of financial operations of the funds and account groups of the governmental unit in conformity with generally accepted accounting principles; and (b) to determine and demonstrate compliance with finance-related legal and contractual provisions.

Fund Accounting Systems

2. Governmental accounting systems should be organized and operated on a fund basis. A full is defined as a fiscal and accounting entity with a self-balancing set of accounts

recording cash and other financial resources, together with all related liabilities and residual equities or balances and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

Types of Funds

3. The following types of funds should be used by state and local governments:

Governmental Funds

(1) *The General Fund …*
(2) *Special Revenue Funds…*
(3) Capital Project Funds…
(4) Debt Service Funds…
(5) Special Assessment Funds…

Proprietary Funds

(6) Enterprise Funds…
(7) Internal Service Funds…

Fiduciary Funds

(8) *Trust and Agency Funds*

Number of Funds

4. Governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established, however, since unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration.

Accounting for Fixed Assets and Long-term Liabilities

5. A clear distinction should be made between (a) fund fixed assets and general fixed assets and (b) fund long-term liability and general long-term debt.
   a. Fixed assets related to specific proprietary funds or Trust Funds should be accounted for through those funds. All other fixed assets of a governmental unit should be accounted for through the General Fixed Assets Account Group.
   b. Long-term liabilities of proprietary funds, Special Assessment Funds, and Trust Funds should be accounted for through those funds. All other unmatured general long-term liabilities of the governmental unit should be accounted for through the General Long-term Debt Account Group.

Valuation of Fixed Assets

6. Fixed assets should be accounted for at cost or, if the cost is not practicably determinable, at estimated cost. Donated fixed assets should be recorded at their estimated fair value at the time received.

Depreciation of Fixed Assets

7. a. Depreciation of general fixed assets should not be recorded in the accounts of governmental funds. Depreciation of general fixed assets may be recorded in cost accounting systems or calculated for cost finding analyses; and accumulated depreciation may be recorded in the General Fixed Assets Account Group.
   b. Depreciation of fixed assets accounted for in a proprietary fund should be recorded in the account of that fund. Depreciation is also recognized in those Trust Funds where expenses, net income, and/or capital maintenance are measured.

Accrual Basis in Governmental Accounting

8. The modified accrual or accrual basis of accounting, as appropriate, should be utilized in measuring financial position and operating results.
   a. *Governmental fund* revenues and expenditures should be recognized on the modified accrual basis. Revenues should be recognized in the accounting period in which they become available and measurable. Expenditure should be recognized in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on general long-term debt and on special assessment indebtedness secured by interest-bearing special assessment levies, which should be recognized when due.
   b. *Proprietary fund* revenues and expenses should be recognized on the accrual basis. Revenue should be recognized in the accounting period in which they are earned and become measurable; expenses should be recognized in the period incurred, if measurable.
   c. *Fiduciary fund* revenues and expenses or expenditures (as appropriate) should be recognized on the basis consistent with the fund's measurement objective. Nonexpendable Trust and Pension Trust Funds should be accounted for on the accrual basis; Expendable Trust Funds should be accounted for on the modified accrual basis. Agency Fund assets and liabilities should be accounted for on the modified accrual basis.
   d. *Transfers* should be recognized in the accounting period in which the interfund receivable and payable arise.

Budgeting, Budget Control, and Budget Reporting

9. a. An annual budget(s) should be adopted by every governmental unit.
   b. Budgetary comparisons should be included in the appropriate financial statements and schedules for governmental funds for which an annual budget has been adopted.

Transfer, Revenue, Expenditure, and Expense Account Classification

10. a. Interfund transfers and proceeds of general long-term debt issues should be classified separately from fund revenues and expenditures or expenses.
    b. Governmental fund revenues should be classified by fund and source. Expenditures should be classified by fund, function (or program), organization unit, activity, character, and principal classes of objects.
    c. Proprietary fund revenues and expenses should be classified in essentially the same manner as those of similar business organizations, functions, or activities.

Common Terminology and Classification

11. A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports of each fund.

Interim and Annual Financial Reports

12. a. Appropriate interim financial statements and reports of financial position, operating results, and other pertinent information should be prepared to facilitate management control of financial operations, legislative oversight, and where necessary or desirable, for external reporting purposes.
    b. A comprehensive annual financial report covering all funds and account groups of the governmental unit — including appropriate combined, combining and individual fund statements; notes to the financial statements; schedules, narrative

explanations; and statistical tables — should be prepared and published.

c. General purpose financial statements may be issued separately from the comprehensive annual financial report. Such statements should include the basic financial statements and notes to the financial statements that are essential to fair presentation of financial position and operating results (and changes in financial position of proprietary funds and similar Trust Funds).

New Financial Reporting Model Under GASB Statement No. 34. GASB *Statement 34* (issued in 1999) is the most far-reaching standard in American state and local government accounting in the last thirty years. It requires governments to present two government-wide financial statements: a statement of net assets with a broad measurement focus and a statement of activities prepared under the accrual basis of accounting. As a result, general fixed assets and general long-term liabilities are brought onto the government-wide balance sheet, making the account groups obsolete. *Statement No. 46* (issued in 2004) clarifies the requirements in *No. 34* that restrictions on net assets by legislation be disclosed. (Legally enforceable restrictions arise when parties outside of government can compel the government to honor those restrictions.) *Statement No. 34* has retained fund financial statements, but put a greater emphasis on the so-called major funds, i.e. funds that are sufficiently large that they are individually featured in the fund financial statements.

Accounting and Reporting Entity. As NCGA *Statement 1* makes clear, funds are the basic accounting entity in government. *Statement 1* further mandated a set of uniform fund types that made possible to prepare aggregated financial statements, with each fund type occupying one column in the combined financial statements. GASB *Statement No. 6* (issued in 1987) eliminates special assessments as a fund type and distributed the transactions previously reported there to other fund types. With the change in fund structure, GASB *Statement No. 37* (issued in 2001) amends GASB *Statement No. 21* (issued in 1993) by requiring escheat property be reported in private-purpose trust funds instead of expendable trust funds.

GASB *Statement No. 14* (issued in 1991) defines the government financial reporting entity. The standard requires the reporting entity be the primary government and the component units for which the primary government is financially accountable even though the component units are legally independent. Later GASB *Statement 39* (issued in 2002) clarifies that an organization that raises and holds economic resources for the direct benefits of the primary government should be regarded as a component unit and be included in the financial reporting entity.

Standards on Recognition, Measurement Focus and Basis of Accounting. Even though Principle 8 in NCGA *Statement No. 1* endorsed the use of accrual basis in government accounting, it also allowed governmental funds to use the modified accrual basis of accounting. The modified accrual basis stresses the availability of current financial resources in recognizing revenue, and the use of current financial resources in recognizing expenditures. GASB *Statement No. 11* (issued in 1990) sought to broaden the measurement focus of governmental funds to include all financial resources and to recognize operating debts incurred to finance recurring operations. (Operating debts, such as employee pension benefits, are the cost of service deferred to the future for payment, in contrast to capital debt for acquiring fixed assets). Opposition led to the adoption of GASB *Statement No. 17* (issued in 1993) that put off the effective date of *Statement No. 11*.

It was not until GASB *Statement No. 34* (issued in 1999) that the measurement issues were comprehensively resolved. Since *Statement No. 34* requires both accrual-based government financial statements, and modified accrual-based financial governmental funds, both bases found their place in the new reporting model. GASB *Statement No. 33* (issued in 1998) establishes legally enforceable claim as the basis for accruing revenues from non-exchange transactions involving taxes and grants for reporting in government-wide financial statements. There was no need to change the measurable and available criteria for recognizing tax and grant revenues under the modified accrual basis. The comprehensive *Statement No. 33* superseded *Statement No. 22* (issued in 1993) on taxpayer-assessed tax revenues in governmental funds, and *Statement No. 24* (issued in 1994) on certain types of grants and financial assistance. Afterwards, *Statement No. 36* requires recipients of shared taxes to account for those taxes in the same way as the provider government.

Relations with the Budget. The GASB has endorsed the position taken by NCGA *Statement No. 1* with regard to budgeting, budgetary control, and budgetary reporting. That is, it is a function of accounting to facilitate budgetary control during the fiscal year, and to assess budget compliance by including budget comparison in year-end financial reporting. In this spirit, GASB *Statement No. 34* requires budgetary comparison using the budgetary basis as well as reconciliation between the budgetary basis and the modified accrual basis required by GAAP for governmental funds. *Statement No. 41* (issued in 2003) permits budgetary comparison based on the budget in case significant structural differences makes it impossible to prepare budgetary comparison for the general fund and each major special revenue fund.

Financial Disclosures. The GASB, like the NCGA, believes that financial statements can be better understood with the aid of supplementary information. *Statement No. 34* requires a Management's Discussion and Analysis (MD&A) to precede the financial statements. *Statement No. 38* (issued in 2001) specifies eleven items of disclosure to be included in notes to the financial statements required by *Statement No. 34*. More recently, *Statement No. 44* (issued in 2004) requires the statistical section in the CAFR to report financial trends, revenue capacity, debt capacity, demographic and economic information and operating information, including information from the government-wide financial statements.

Specific Standards

Approximately two-thirds of GASB standards are classified as specific standards in that they apply the general standards to deal with specific entities or activities, transactions, or elements of financial statements. This does not mean, however, that the

GASB first set forth the generally principles and then apply them to deal with specific situations. These standards are briefly described in an appendix at the end of chapter, but will not be analyzed individually because the highly technical and often unique to American state and local governments.

The thirty-two specific standards cluster in four groups: eight standards deal with the application and applicability of business accounting (particularly FASB) standards; thirteen standards concern employee compensation; five standards deal with investments, insurance and similar issues; and six standards address particular assets and liabilities.

GASB Standards on Business and Nonprofit Entities and Activities. American state and local governments own or control a significant number of business enterprises and nonprofit institutions. Should these "special entities" follow FASB or GASB standards? On November 30, 1989, the Financial Accounting Foundation reached a jurisdictional agreement with the concerned parties. That date has been used to decide the issue of the applicability of FASB standards. The business and nonprofit organization in the state and local public sector can either (a) apply GASB standards and pre-November 30, 1989 business GAAPs not in conflict with GASB standards, or (b) apply business GAAPs except those conflicting with GASB standards. Exhibits 5.2 lists GASB standards that attempt to clarity the applicability of GASB and the FASB standards.

Exhibit 5.2
GASB Standards on Business and Nonprofit Entities and Activities

- Statement No. 8. Applicability of FASB Statement No. 93,"Recognition of Depreciation by Not-for-Profit Organizations," to Certain State and Local Governmental Entities
- Statement No. 9. Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting
- Statement No. 15 Governmental College and University Accounting and Financial Reporting Models
- Statement No. 18. Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs
- Statement No. 19. Governmental College and University Omnibus Statement—an amendment of GASB Statements No. 10 and 15
- Statement No. 20. Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting
- Statement No. 29. The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities
- Statement No. 35. Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities—an amendment of GASB Statement No. 34

Standards Concerning Employee Compensation. Public employee compensation includes salaries and wages, fringe benefits, deferred compensation, pension benefits, and other post-employment benefits, such as health care, life insurance, collectively called OPEB). Since its establishment, the GASB has continuously worked on this important and controversial area, producing thirteen standards. Most of the accounting recognition and measurement problems are due to the nature of defined benefits plans for pension and OPEB that many state and local government offer their employees. The amount and timing of the benefits are uncertain. In addition, some or many employer governments have not made adequate contributions as determined by independent actuaries. GASB standards (listed in Exhibit 5.3) therefore pertain to accounting and financial reporting by employers who are ultimately responsible for their own promises, as well as by pension and OPEB plans, which receive contributions, invest them and distribute benefits.

The following general approach has evolved. Employers are required to measure and disclose their annual pension and OPEB expense, which includes annual required contributions, as adjusted by the amortization of accumulated obligations. Pension and OPEB plans are required to present two types of information: (a) current financial information about their net plan assets and changes in those assets, and (b) long-term actuarial information about the funded status and progress toward full-funding.

Exhibit 5.3
GASB Standards on Employee Compensation

- Statement No. 2. Financial Reporting of Deferred Compensation Plans Adopted under the Provisions of Internal Revenue Code Section 457
- Statement No. 31. Accounting and Financial Reporting for Certain Investments and for External Investment Pools
- Statement No. 32. Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans—a rescission of GASB Statement No. 2 and an amendment of GASB Statement No. 31
- Statement No. 4. Applicability of FASB Statement No. 87, “Employers’ Accounting for Pensions,” to State and Local Governmental Employers
- Statement No. 5. Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers
- Statement No. 12. Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers
- Statement No. 16. Accounting for Compensated Absences
- Statement No. 25. Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans
- Statement No. 26. Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans
- Statement No. 27. Accounting for Pensions by State and Local Governmental Employers
- Statement No. 43. Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans
- Statement No. 45. Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions
- Statement No. 47. Accounting for Terminal Benefits

Standards Dealing with Investments and Risks. A substantial amount of many state and local governments’ financial resources is in the form of securities. These governments engage in complex transactions to increase their returns on investment and manage their risks. The GASB has issued a half dozen standards (see Exhibit 5.4) to compel governments to make adequate disclosure about their investment practices and risk exposure.

Exhibit 5.4
GASB Standards on Investments and Risk

- Statement No. 3. Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements
- Statement No. 10. Accounting and Financial Reporting for Risk Financing and Related Insurance Issues
- Statement No. 28. Accounting and Financial Reporting for Securities Lending Transactions
- Statement No. 30. Risk Financing Omnibus—an amendment to GASB Statement No. 10
- Statement No. 40. Deposit and Investment Risk Disclosures—an amendment of GASB Statement No. 3

Specific Assets and Liabilities. Finally, the GASB, in response to requests for guidance, has issued a number of standards about specific transactions, assets, and liabilities (see Exhibit 5.5).

Exhibit 5.5
GASB Standards on Specific Assets and Liabilities

- Statement No. 7. Advance Refundings Resulting in Defeasance of Debt
- Statement No. 13. Accounting for Operating Leases with Scheduled Rent Increases
- Statement No. 23. Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities
- Statement No. 42. Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries
- Statement No. 48. Sales and Pledges of Receivable and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues

Concluding Remarks

During the period from 1984 to 2006, the Governmental Accounting Standards Board (GASB) produced forty eight standards, in addition to a few Statements of Concepts and other standards with lower level of authoritativeness, such as Interpretations and Technical Bulletins. About a third of these standards may be considered as general standards, and the rest as specific standards. The general standards cover topics including: the financial reporting model, accounting and reporting entity, elements of financial statements and related recognition and measurement criteria, and the relationship between financial accounting and budgeting, and financial disclosure. The standards in each area were identified and their relationship briefly explained. Most of the specific standards deal with employee pension and other post-employment benefits; investments and risks; specific assets and liabilities; and the application and applicability of FASB standards to business and nonprofit entities and activities in the public sector.

ACCOUNTING POLICY SPACE

Introduction

In setting standards, the GASB and FASAB accept some options and reject others. What are these options? The concept of "government accounting policy space" is proposed to encompass all conceivable government accounting policy alternatives. For example, {accrual basis, a fund, cash basis, a whole government} is a set of alternative accounting policy options. Accrual basis and cash basis are alternative bases of accounting, while a fund and a whole government are alternative reporting entities. Therefore the government accounting policy space is defined in terms of various dimensions or aspects, such as reporting entity and basis of accounting. Once the dimensions are identified, the alternatives can be identified and arranged along each one of these dimensions.

Ten Dimensions of the Accounting Policy Space

The dimensions of the government accounting policy space correspond to areas of concern to government accountants and accounting policy makers:

1. What should be the capability and objectives of a government's accounting system?
2. What should the relationship be 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. How many financial statements are necessary and how are they related?
6. Should financial accounting only deal exclusively with the past?
7. What criteria should be used to recognize some resources as assets and some obligations as liabilities?
8. What kind 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?

In brief, the ten dimensions refer to:

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

The key terms used in the following discussion of government accounting policy space are defined in Exhibit 5.6.

Exhibit 5.6
Key Terms in Financial Accounting and Reporting

Financial Reporting
Reporting entity: consists of one or more organizations whose finances are of interest to intended users of a financial report. *Financial statements*: report the recognized effects of transactions and events, consisting of statements of financial position, financial performance, and cash flows. *Government-wide (or consolidated) financial statements*: financial overview of the government as a whole, after eliminating the effects of internal transactions. *General-purpose external financial statements*: intended to be the primary source of historical financial information to users outside of an entity, prepared with generally accepted accounting principles. *Financial report*: financial statements and other financial disclosures. *Financial position*: as of a particular date, an entity's net assets are its assets offset by its liabilities. *Financial performance*: changes during a period in an entity's amount of net assets, as measured by revenues net of expenses. *Cash flows*: sources and uses of cash from operating, financing and investing activities.
Financial Accounting Measurement
Transactions: the primary source of financial accounting data, exchanges of economic considerations between two or more parties. *Events:* a significant occurrence that has direct or indirect consequences to an entity. *Financial consequences*: impacts on an entity's financial position and performance or cash flows. *Elements of financial statements*: indicators of financial consequences and therefore major components of financial statements: assets, liabilities, revenues, expenses. *Assets*: range from cash to any economic resources capable of producing future benefits. *Liabilities*: obligations to pay in cash or to provide services due to having received benefits. *Revenues*: increases in assets (or decreases in liabilities) attributable to service efforts and accomplishments or government's power to tax. *Expenses*: assets used or liabilities incurred in the course of generating revenues. *Realization*: financial consequences having been confirmed by an actual transaction or event. *Recognition*: the decision and action to formally acknowledge certain financial consequences in the accounts and financial statements. *Cash basis:* measures financial performance in terms of cash receipts and disbursements. *Accrual basis*: in contrast to cash basis, broadens revenue to include receivables (claims against customers or taxpayers) and expenses to include non-cash resources used and incurrence of liabilities.

Matching: offsets revenues by related expenses to arrive at a net periodic measure of financial performance, such as income or loss.

Multiple Choices along Each Dimension

Each one of the above questions can be answered in several ways. Thus standard setting is similar to answering multiple-choice questions: selecting the best alternative from the available options. This section will identify some major options in each dimension.

1. ***Capacity and Objectives***. A government's accounting system can be designed to achieve one or more of the following objectives:
   (a) monitor 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***. The range of 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 budgeting rules
   (d) budgeting uses accounting concepts and measurement rules

3. ***Accounting and Financial Reporting Entity***. The range of possibilities of accounting and financial reporting entity includes:
   (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 and the government as a whole
   (d) components of a government, such as funds and organizational units

4**.** ***Accounting System Architecture***. The accounting system could be:
   (a) a single-entry system
   (b) a double-entry system, which involves a commitment to 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 double-entry recording system and the underlying conceptual model of accounting equation lead to two fundamental financial statements: a statement of financial position at the end of a period, and a statement of financial performance in a period. Furthermore, financial performance is expressed in terms of changes in net assets, which are traceable to changes in assets and liabilities (see Exhibit 5.7).

Exhibit 5.7 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 t+1:					
Revenue	increase		decrease		increase
Expense or expenditure	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 refers to waiting for actual transactions or events to confirm speculations about the value of something. Financial accounting could admit into the accounting system one or more of the following:

(a) the consequences of what has happened
(b) speculations about what has not happened in limited circumstances, such as unrealized gains or losses of financial investments
(c) speculations 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 be 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 one or more of the following:

(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 type of resources that are recognized as assets and the type of obligations that are recognized as liabilities. Both assets and liabilities can be further classified as short-term or long-term (Exhibit 5.8).

Exhibit 5.8 Measurement Focus Possibilities
Panel A: Assets

Type / Timing	Financial Resources	Non-financial Resources	
		Non-capital	Capital
Current	yes/no	yes/no	(null)
Non-current	yes/no	yes/no	yes/no

Panel B: Liabilities

Type / Timing	Operating Debts	Capital Debts
Current	yes/no	yes/no
Non-current	yes/no	yes/no

Operating debts are service costs deferred to the future for payment, such as employee retirement pension and health care benefits. Capital debts finance acquisition or construction of fixed assets.

9. ***Basis of Accounting***. Basis of accounting refers to the method for measuring 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 alternative bases of accounting are:

(a) cash basis
(b) accrual basis

In business accounting, where most transactions are reciprocal exchanges, the accrual basis has a standard meaning. Revenue is recognized to the extent of goods sold or service delivered, that is, based on service efforts and accomplishment (SEA). Expenses are the assets used and liabilities incurred in generating the recognized revenue. A period's expenses are matched against revenue to derive the amount of income. This SEA-based accrual is sometimes called full accrual, and is commonly used in measuring the performance of business-type activities of government.

Accounting for governmental activities and governmental funds uses a basis that modified the full accrual basis to take into account the availability and use of net assets. Since there are different kinds of assets and liabilities (Exhibit 5.8), there are correspondingly different measures of revenue and expense or expenditure. In order to clarify the extent of modification, accrual is expressed in degrees (Exhibit 5.9).

Exhibit 5.9
The Degrees of Accrual

Revenue	**Degrees of Accrual**	**Expense or Expenditure**
recognition on the basis of service efforts and accomplishment (SEA)	Full accrual	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 a legally enforceable claim	Strong accrual	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	Moderate accrual	expense: use of financial resources, and incurrence of financial liabilities regardless of timing
recognition on the basis of the availability of current financial resources	Mild accrual (equivalent to modified accrual)	expenditure: use of current financial resources, and the incurrence of current liabilities

10. Unit of Measurement. The U.S. dollar is used in the United States to measure assets and liabilities. Assets are usually stated in terms of historical cost, and liabilities in the amounts specified in debt instruments. Other possibilities have been extensively debated in business accounting, but are hardly discussed in government accounting. These theoretical possibilities, however, should not be dismissed.
The unit of measurement could be:

a. unadjusted U.S. dollar
b. U.S. dollar adjusted for inflation
c. U.S. dollar adjusted for specific price-level changes

Asset valuation basis could be:

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

Liability valuation basis could be:

a. nominal contractual price
b. nominal contractual price adjusted for time value of money
c. actuarial estimates, reflecting uncertainty as well the time value of money

In summary, there are ten dimensions or aspects in the government accounting policy space. Along each dimension, often more than one choice is possible. Accounting standard setting involves two types of decision-making: (1) deciding the dimension to be addressed, and (2) in each dimension, deciding which option or options to require or permit.

A Characterization of American Government Accounting Standards

In the next section, the choices embodied in the GASB and FASAB standards are identified.

Capacity and Objectives; Relation with the Budget

Both the GASB and the FASAB focus their standards on financial accounting in order to the accurately measure and communicate financial consequences of past decisions and actions in general purpose external financial reports. However, both boards recognize that a government accounting system requires the capacity to monitor legal, budgetary, and contractual compliance, and communicate the information in special purpose reports.

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

- Budget concepts and measurement rules are used in preparing budget execution reports during the fiscal year in both the Federal Government and state and local governments.
- Actual-to-budget comparisons are included in some fund financial statements but not in government-wide financial statements in state and local governments. No such comparisons are include in government-wide or agency financial statements of the Federal Government.
- When the budgetary basis differs from the accounting basis, numbers prepared under different rules are reconciled in both Federal and state/local government financial reports.
- GASB and FASAB standards are not constrained by budget rules, so that liabilities can be recognized regardless of whether they are funded or not. Similarly, American government budgeting generally does not use accounting concepts and measurement rules, such as the long-term perspective of the balance sheet and the accrual basis in recognizing revenues and expenses.

Accounting and Financial Reporting Entity

Both the FASAB and GASB require government-wide financial statements, which do not include fiduciary activities. The Federal Government's consolidated financial statements have one column for the entire government, with the interactions among Federal activities, such as between the general fund and social security trust funds described in the notes. In contrast, 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 reported in separate columns, before they are summed up in the government-wide totals.

Virtually all major Federal Government agencies prepare and separately issue agency-wide financial statements. 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 government-wide financial statements, in a government's comprehensive annual financial reports.

Accounting System Architecture and Financial Statements

FASAB and GASB standards assume governments use the double-entry recording system. Neither board prescribes charts of accounts, leaving this task to the governments themselves. In the Federal Government, the Treasury's Financial Management Service requires Federal agencies to adopt the requirements of the Standard General Ledger. GASB only requires governments to have uniform terminology and account classification for budgeting, accounting and financial reporting.

The universal use of double-entry recording greatly facilitates the preparation of two fundamental financial statements: a statement of financial position at the end of a period, and a statement of financial performance in a period by all American governments. State and local governments have cash flow statements only for their funds that finance business activities. However, the Federal Government publishes a separate statement of cash receipts, outlays and balances for the entire Federal Government and its components. In addition to the consolidated balance sheet and statement of operations, there are two schedules to reconcile the accrual-based deficit to cash deficit and cash position. There are additional financial statements: Federal agencies report budget performance, and state and local governments present numerous fund statements.

Realization

Both the FASAB and GASB adhere to the realization principle and focus on the measurement and reporting of past transactions and events. Thus the cost of deferred maintenance, for example, is not reported in the financial statements, but could be disclosed in the notes or elsewhere. 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 points are the transactions or events that have happened.

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) being owned or controlled by the government, and (c) being a consequence of past transactions or events. The liability recognition criteria include all of the following: (a) requiring future cash outflow or service delivery; (b) being unavoidable and having definite amounts and timing, and (c) being a consequence of past transactions or events.

The application of these criteria rules out the recognition of obligations under executory or unperformed contracts as liability. GASB standards requires contractual obligations be reported as a classification of fund balance, specifically 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.

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. Furthermore, in a possible deviation from the realization principle, Federal government agencies recognize "fund balance with Treasury" as an intra-governmental asset, thus triggering the recognition of unexpended appropriations as the agency's net asset.

Both the GASB and FASAB have taken giant steps in broadening the range of assets and liabilities on the balance sheet. American governments at all levels report a full range of financial resources and non-financial resources, including infrastructure and other capital assets. Furthermore, the Federal Government reports Stewardship Assets and Stewardship Responsibilities, which are Federal resources and responsibilities that do not meet recognition criteria, or cannot be feasibly measured in financial terms.

American governments have done well in recognizing, measuring, and reporting short-term liabilities. However, problems and controversies abound in the long-term liability area. 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 financed by borrowing. Thus it is impossible to know (a) the size of the Federal Government's operating deficit, and (b) the amount of capital borrowing. The Federal Government does recognize pension and benefits payable to current and retired civilian and military employees.

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, as well as current revenues if possible. Since 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 its effort and influence. There are two kind of operating debts: 1) explicit borrowing to cover operating deficit; 2) the costs of current services deferred to the future for payment. The GASB has issued a number of standards requiring state and local governments — as employers and as sponsors of public employee retirement plans — to disclosure long-term information about their unfunded actuarial liabilities for both pension benefits and other post-employment benefits (OPEB).

The recognition of long-term operating debt is coordinated with the movement 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, the cost of government services includes not only salaries paid, but also short-term salaries payable, as well as long-term pension and OPEB payable. Depreciation expense is also a component of service cost. 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 principle of strong accrual in recognizing taxes, grants and other revenues form non-exchange transactions. However, the Federal Government has admitted that it uses a near-cash basis in recognizing income taxes.

Unit of Measurement

Neither the FASAB nor the GASB has issued standards specifically dealing with the unit of measurement issue. By default, American governments use the nominal U.S. dollar as unit of measurement. 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. Short-term liabilities are measured at their contractual price; present value and actuarial estimates are used for long-term liabilities.

SUMMARY AND CONCLUSION

Despite their separate jurisdictions, the FASAB and the GASB both favor full disclosure for demonstrating and assessing government accountability, and both use essentially the same due process. Consequently, there are enough common features to constitute a set of general principles for American government accounting Principles are broader and more general than most standards. As the FASAB and GASB have produced many statements of standards by now, it is both necessary and worthwhile to generalize them to the extent possible. Unlike the boards' codifications, the following principles are distillations rather than condensations of current standards. It goes without saying that they do not have 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 conform 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's 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 for the flexible combination of entities for different purposes.

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

Principle 5. ***Financial Statements***. Financial statements are at 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 positions. 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 to reveal significant internal financial relationships. Additional required and discretionary disclosures should be made to supplement and complement these fundamental financial statements.

Principle 6. Realization or Historical Orientation. 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 which are 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 offsetting liabilities against assets. Contractual obligations are not liabilities and may be disclosed in the net assets or fund balance section of the balance sheet. 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. Likewise, 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 the 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 calculating revenues and expenses or expenditures. The 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. Financial records and financial statements are usually not adjusted for change in the purchasing power of the measurement unit, which is the dollar in the United States. However, during periods of significant inflation, financial trend information should be so adjusted.

APPENDICES
[omitted]