

AMERICAN GOVERNMENT ACCOUNTING

Institutions, Concepts,
and Standards

Issues to Address

- ** Who are the stakeholders of FASAB and GASB?
- *** What are the ten areas of concerns in govt. accounting standard setting?
- *** What are the alternatives in each area of concern?
- * What are the costs and benefits associated with each alternative?

Background Readings

- Chan, *American Govt. Accounting Standards*, Chapter 4 “Institutions, Processes, and Outputs”
 - ** Stakeholder theory
 - * detailed institutional features of GASB and FASAB
- Chan, *American Govt. Accounting Standards*, Chapter 5 “Structure of Standards”
 - *** Ten issue areas (“accounting policy space” in Chapter 5, also in “Less is More” paper published in 2007
 - * Enumeration of specific GASB and FASAB standards

American Government Standards and Standard Setting

Multiple Institutions And Processes

Institutional Profiles

Description

Government Accounting Rules

Generally Accepted Accounting Principles (GAAP)

- Governmental Accounting Standards Board (GASB) for state and local governments in the U.S.
- Federal Accounting Standards Advisory Standards (FASAB) for the Federal Government

Government Rules valid only within each jurisdiction

- Laws
 - State statutes
 - Local ordinances
- Regulations issued by
 - State Comptrollers (chief accounting officer)
 - State Auditors
 - State budget directors

AICPA and GAAP

- AICPA involvement is due to governments' engaging **CPAs** to perform independent **(external) audits** of their financial statements.
- A **unqualified audit opinion** requires certification that the financial statements **comply with GAAP** on a consistent basis.
- Under the AICPA's Code of Professional Conduct, CPAs are required to follow GAAP or justify departures from GAAP.
- AICPA recognizes only certain organizations' **authority to set GAAP**.

Government and GAAP

- “GAAP” originally covered only business accounting and standards set by the Financial Accounting Standards Boards.
- Now GAAP applicable to
 - Private sector business firms and nonprofit organizations.
 - State and local governments
 - Federal Government
- Governments follow GAAP to increase the credibility in their financial reports and to lower their cost of borrowing from the capital markets.

Scope of Coverage of GASB and FASAB Standards

- GASB standards are applicable to **state and local governments** and their business enterprises and nonprofit entities.
- FASAB standards are applicable to the **Federal Government** as a whole and all federal organizational units, including business enterprises and nonprofit entities.
- Both GASB and FASAB in substance adopt FASB standards for their **business enterprises**.

FASAB

- The FASAB was established in 1990 on the basis of a [Memorandum of Understanding](#) between the Secretary of the Treasury, the director of the Office of Management and Budget (OMB) and the Comptroller General (head of the GAO).
- The ratio of official and public members were reversed (from 6:3 to 3:6) in 2003 in order to gain [recognition by the AICPA](#).
- Now FASAB standards are effective unless vetoed by one of its three sponsors.

GASB

- The GASB was established in 1984 by the FAF in agreement with the organizations representing governments and their officials, accounting and public finance professionals and capital market participants – all on its [advisory council](#).
- The GASB gained [AICPA recognized](#) in 1986.
- GASB standards are effective upon adoption by the board.

Institutions and Processes

- Different governance structures:
 - Governmental Accounting Standards Board (GASB)
 - Federal Accounting Standards Advisory Board (FASAB)
- Independence within limits
- Constituencies
- Due process

Common Emphasis of the GASB and FASAB

- External reporting to users to discharge government's accountability.
- Government-wide financial statements and disclosures.
- Acceptance of accrual basis at least in principle.
- Acceptance of a broad measurement focus for the balance sheet.
- Actual financial performance compared or reconciled with the budget.
- Use of "Management discussion and analysis" to help users understand a government's finances.

Common Standard-setting Approach of the GASB and FASAB

- Both GASB and FASAB are sensitive about guarding the jurisdiction of their authority, with informal exchanges but no formal mechanism for harmonization.
- Both GASB and FASAB have mostly part time board members and full-time staff.
- Both GASB and FASAB encourage broad public participation in the “due process” in order to increase compliance.

Common Approaches (cont'd)

- Both boards have emphasized responsiveness to urgent and practical issues.
- Both boards have used the incremental approach and issued individual standards that vary in scope and substance.
- Both boards have found it necessary to resolve fundamental conceptual issues, after only preliminary efforts to create a conceptual framework.
- Both boards have attempted to deal with these issues:
 - Reporting entity.
 - Relationships between accounting and the budget.
 - Measurement focus and basis of accounting.
 - Measurement of assets, liabilities, revenues and expenditure/expenses.

Differences between FASAB and GASB

FASAB

- FASAB is an inter-branch cooperative mechanism in the Federal Government.
- FASAB is under direct government oversight.
- FASAB standards are enforced through legislative and administrative requirements.

GASB

- GASB is a non-governmental body under a private-sector foundation.
- Governments participate in advisory council.
- GASAB standards are enforced through external audits and capital markets.

Differences between GASB and FASAB

FASAB

- Standards cover management and cost accounting
- Congress and managers among primary users
- Departments issue external reports

GASB

- Only financial accounting standards for external reports
- Creditors and investors among primary users
- Presentation of major funds in financial statements

Conclusion

- The United States have two government accounting standards boards due to its federal system.
- The GASB and FASAB share a common concerns for financial accountability and have used similar approaches.
- Independent audits enhance the credibility of government reporting and have encouraged the development of GAAP.

Institutional Analysis

Applying Organization Theory

- GASB and FASAB is each a system that converts inputs into outputs, and reconverts outputs into inputs to ensure survival (see Exh. 4.1 and 4.2)
- GASB and FASAB is each an organization with its distinctive stakeholders, who require inducements to continue their contributions (see Exh. 4.5 and Exh. 4.6)

A Comparative Summary of GASB and FASAB

- Details in Exh. 4.7
- Similarities
 - Focus on financial accounting and general purpose external financial reporting
 - Standards recognized as GAAP after due process
 - Part-time board with full-time staff and volunteers

Comparison of GASB and FASAB

- Dissimilarities
 - Jurisdiction (domain)
 - Sponsorship and oversight
 - Legal authority
 - Enforcement
 - Funding
 - Dissemination of standards

The Structure of Government Accounting Standards

Issue Areas, Options,
and Choices

Preliminary Observations

GASB and FASAB Standards as Variants of American Model

- Because of the jurisdictional division there does not exist a general American model of govt. accounting and financial reporting.
- Despite many differences between federal and state and local standards and practices, there are sufficient similarities to constitute an American model of government accounting and financial reporting.

Year-round Accounting and Year-end Financial Reporting

- In daily operations, the compliance and management support functions of government accounting are at least as important as year-end financial reporting to the public.
- The current American practice has evolved over the past one hundred years, with each period emphasizing different functions of a government's accounting system.

Cost-Benefit Criterion, and Report and System Specification

- The board all invoke the cost-benefit criterion in adopting standards; in practice, they emphasize the benefits of full disclosure and say little about the of implementation.
- GASB (more so than FASAB) standards tend to pay more attention to the specification of the contents of financial statements and disclosures than to modifications of accounting systems

No Charts of Accounts, and Recursive Incremental Method

- American accounting standards boards have refrained from prescribing charts of accounts and other accounting system specifications.
- Accounting standards boards have used a “recursive incremental” approach: one standard at a time, being responsive to current demands, adopting consensus standards and deferring controversial issues, revisiting basic concepts from time to time.

All Standards Are Not Created Equal, Standards Overload

- As of May 2008, the FASAB has produced 32 standards since 1991 and the GASB 52 standards since 1984. Some standards are more important and substantive than the others.
- “Standards overload” has become a serious concern. **The time has come to generalize the standards.**

Conceptual Framework, and Middle-range Principles

- The standards boards believe in the need for conceptual frameworks and have all attempted to establish them, but they have all fallen short of producing a framework to operationally guide standard setting.
- I propose a “middle range” approach of deriving a manageable number of tentative principles from the standards toward specifying the American model of govt. acctg.

Ten Areas of Concerns

Financial Accounting
Standard Setting

Ten Issue Areas

1. Objectives and system capability.
2. Relationship with budgets.
3. Accounting and reporting entity.
4. System architecture (accounting equation and elements)
5. Form and contents of financial statements

Issue Areas (cont'd)

6. Time orientation and realization.
7. Accounting recognition criteria.
8. Measurement focus for determining financial position.
9. Basis of accounting for determining financial performance.
10. Measurement unit and valuation.

Issue 1. Objectives and System Capability

- Relative weight of the following:
 - For determining and demonstrating compliance with finance-related legal and contractual provisions;
 - For supporting financial management, including budget execution;
 - For fair presentation in accordance with generally accepted accounting principles.

Principle 1: Objectives and Capability

- A govt's accounting system should be capable of producing information for: (1) determining and demonstrating compliance with finance-related legal and contractual provisions; (2) supporting financial management, and (3) fair financial presentation in accordance with GAAP.

Issue 2:

Relationship with Budgets

- Range of relationships:
 - Reconciliation of actual results with budgeted results on the budgetary basis.
 - Comparison of actual results with budgeted results on the budgetary basis.
 - Comparison of actual results with budgeted results on a GAAP (accrual) basis.
 - Budgeting on a GAAP (accrual) basis.

Principle 2: Relationship with Budgets

- A government should produce and make public its annual budgets in terms of projected revenues and authorized expenditures. Its financial report should include at least a reconciliation and preferably a comparison of the actual and expected financial performance.

Issue 3:

Accounting and Reporting Entity

- One column for whole government only
- One column for whole govt., and another column for legally separate but financially accountable entities
- One column each for governmental activities, another column for business-type activities, and total column for whole government
- Whole govt. statements complemented by financial statements for departments and funds

Principle 3:

Accounting and Reporting Entity

- Accounting and reporting entities should be defined on the basis of scope of authority and accountability. Financial data should be sufficiently disaggregated to allow for flexible formation of reporting entities. Summary financial statements should disclose significant internal financial relationships.

Issue 4. Accounting System Architecture

- Should the asset [delete asset] accounting system be based on

- A single-entry recording system? Illustration

Beginning balance of any account	xxx
Addition	+
Deduction	-
Ending balance	xxx

- A double-entry recording system? Illustration

Assets = Liabilities + Net Assets

Building and Equipment	+ 1,000	
Bonds Payable		+1,000
Net Assets		+ 0

Principle 4: System Architecture

- A government's accounting system should use the double-entry recording system based on the accounting equation: $\text{assets} = \text{liabilities} + \text{net assets}$, where changes in equity are revenues and expenses. A uniform chart of accounts should be used in budgeting, accounting and financial reporting.

Issue 5:

Financial Statements

- A package of **related financial statements** should include at least:
 - A statement of assets and liabilities at the end of a period, and
 - A statement of revenues and expenses for the period.
- **Issues:**
 - To require a statement of cash flows?
 - To require budget comparison statement/schedule?
 - To require schedules that reconcile numbers?
 - How many supplemental disclosures to require?

Principle 5: Financial Statements

- For any fiscal year, a government should at least present a statement assets and liabilities to show its financial position, and a statement of revenues and expenses to report its financial performance. A cash flow statement is recommended, so are additional disclosures to supplement and complement these financial statements.

Articulated (Interlocking) Financial Statements

- Assets – Liabilities = Net assets or
 $A - L = NA$
- Revenue = increase in NA;
Expense = decrease in NA
- Therefore:
 - Revenue: increase in A, decrease in L
 - Expense: decrease in A, increase in L

Issue 6:

Time Orientation and Realization

- Financial accounting is fundamentally historical in nature. However, it is possible to consider:
 - Realized [deleted] future consequences of past transactions and events; and
 - Unrealized consequences of transactions and events that have not occurred
 - Very few items (e.g. financial investments)
 - Some items
 - Many items

Principle 6: Time Orientation and Realization

- Financial accounting data and financial statements reflect the effects of past transactions and events regardless of the length of time required for those effects to be realized, and historical cost is the basic valuation method. The inclusion of unrealized effects in financial statements should be rare and justified.

Issue 7:

Accounting Recognition

- Accounting recognition stipulates the criteria for considering certain economic resources as assets, and certain responsibilities as liabilities of an entity.
- Issue: What should those criteria be?
 - Assets: future benefit, ownership, control
 - Liability: future sacrifice due to reciprocal benefit, certainty

Principle 7: Accounting Recognition

- Assets are economic resources acquired, owned or controlled by an entity that are capable of producing future economic benefits. Liabilities are the responsibility to pay cash or provide service in the future as a consequence of past transactions or events.

Issue 8: Measurement Focus: Scope of the Balance Sheet

Assets

- Current financial resources
- Long-term financial resources
- Capital resources

Liabilities

- Purpose
 - Operating debt/liability
 - Capital debt/liability
- Timing
 - Current financial liabilities
 - Long-term financial liabilities

Principle 8: Measurement Focus

- A government's balance sheet may be developed in three stages:
- Stage 1 should focus on current financial resources and current financial liabilities.
- Stage 2 generates data on long-term financial resources and long-term financial liabilities.
- Stage 3 further generates data on capital resources, beginning with those used in government operations.

Issue 9:

Basis of Accounting

- **Full accrual** of revenue on the basis of service delivery and matching related expenses are generally not possible in governmental activities.
- Alternatively, **accruals in govt. measure the availability and use of resources.**
- The issue boils down to the **timing** of availability and use of resources, and the kind of resources being measured.

Issue 9 (cont'd).

Which Degree of Accrual?

- **Mild accrual:** **increase in** short-term receivables as revenue and **increase in** short-term liabilities as expenditure.
- **Moderate accrual:** **increase in** long-term receivables also as revenue, and **increase in** long-term liabilities also expense
- **Strong accrual:** receipt of non-financial resources also considered as revenue, and use of non-financial resources as expense.

Principle 9: Basis of Accounting

- The full accrual basis should be used to account for a government's business-type activities.
- The cash-basis is not an acceptable method for measuring financial performance.
- A government's financial performance should be measured by using an accrual basis of the highest degree possible, subject to cost-benefit comparison.

Issue 10:

Unit of Measurement

- The elements of a government's financial statements are usually stated in the units of its national currency.
- Issues arise in translation of foreign currency.
- Two valuation issues exist:
 - Whether to adjust for general or specific price level changes
 - Whether to allow for fair values (net realizable value or current replacement cost).

Principle 10: Measurement Unit and Valuation

- Ordinarily a government's annual financial statements are not adjusted for inflation. Such adjustment is recommended for trend data over a long period of time. Financial assets are generally stated in terms of their fair market value (i.e. net realizable value), and fixed assets in their historical costs adjusted for depreciation. Current liabilities are stated in in contract price, and long-term liabilities in present value of future cash outflows.

Some Specific Terms

Federal Government Per FASAB

- Stewardship assets: unrealized Federal resources, such as land, heritage assets
- Stewardship liabilities: unrealized Federal responsibilities and obligations
- Cost: cost of service, or expense
- Government-responsible events: direct govt. actions giving rise to liability
- Government-acknowledged event: govt. agrees to take responsibility for others' actions

State and Local Government Per GASB

- Interperiod equity: not pushing current cost of service to the future for payment; raising enough current revenues to cover current expenses
- Operating debt: “legacy costs”, or cost of service or expense to be paid in the future
- Capital debt: borrowing to acquire fixed assets
- Modified accrual: equivalent to mild degree of accrual

Next Seminar: Making Sense of Financial Statements

Questions or don't know what
to ask

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Or talk to me