

Basic Facts about GASB's project on Economic Condition Reporting: Fiscal Sustainability

What is economic condition?

Economic condition is a composite of a government's financial position and its ability and willingness to meet its financial obligations and service commitments on an ongoing basis. Economic condition includes three components:

- *Financial position* is the status of a government's assets, liabilities, and net assets, as displayed in the basic financial statements.
- *Fiscal capacity* is the government's ability and willingness to meet its financial obligations as they come due on an ongoing basis.
- *Service capacity* is the government's ability and willingness to meet its commitments to provide services on an ongoing basis.

Where did the term *economic condition* come from?

In Concepts Statement No. 1, *Objectives of Financial Reporting*, the GASB originally employed the terms *financial position* and *financial condition*. However, the GASB came to realize that these terms were defined in a variety of ways by different people, and that other terms also were used to refer to the same concepts. The GASB first employed the term *economic condition* when it was working on Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* during the 1990s, to avoid the confusion associated with the other terms and to embody a comprehensive notion of the assessments of financial health.

What is economic condition reporting?

Economic condition reporting refers to the communication of financial position, fiscal capacity, and service capacity information to assist users in assessing a government's economic condition.

How does economic condition reporting relate to accounting and financial reporting?

The GASB's predecessor, the National Council on Governmental Accounting, highlighted in paragraph 9 of its Concepts Statement 1, *Objectives of Accounting and Financial Reporting for Governmental Units*, that one of the basic objectives of accounting and financial reporting for governmental units is, "To provide financial information useful for determining and forecasting the financial condition of the governmental unit and changes therein:

- For determining the value and forecasting the service potential of resources held by the governmental unit.
- For determining whether the value and service potential of physical resources have been maintained during a period and forecasting the financial impact of maintaining or replacing service capacity.

- For forecasting the amounts and timing of future outflows resulting from existing commitments and the ability of the governmental unit to meet these when they come due.
- For determining and forecasting the cost of programs or services provided by the governmental unit.”

The Financial Accounting Standards Board, the standards setter for private sector organizations, including not-for-profits, states in paragraph 30 of its Statement of Financial Accounting Concepts No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*, “Present and potential users of the information provided by financial reporting by a particular nonbusiness organization share a common interest in information about the services provided by the nonbusiness organization, its efficiency and effectiveness in providing those services, and its ability to continue to provide those services...”

In paragraph 79 of Concepts Statement 1, the GASB identified the provision of information for the assessment of financial position and financial condition as necessary for state and local governments preparing external financial reports. The Concepts Statement indicates that, “Financial reporting should assist users in assessing the level of services that can be provided by the governmental entity and its ability to meet its obligations as they become due by (a) providing information about the financial position and condition of a governmental entity, (b) providing information about a governmental entity’s physical and other nonfinancial resources having useful lives that extend beyond the current year, including information that can be used to assess the service potential of those resources, and (c) disclosing legal or contractual restrictions on resources and risks of potential loss of resources.” (paragraph 79)

How long has the GASB been working on economic condition reporting?

A sponsored-research project on financial condition reporting was first undertaken by the GASB in 1988. A research report, *The Relationships between Financial Reporting and the Measurement of Financial Condition*, by Dr Robert Berne, was published in 1992. Based on the findings of this report, a follow-up research project was added to the GASB’s long-term agenda in 1993. The research on fiscal sustainability actually is the third phase of the GASB’s research on that project, renamed economic condition reporting. The first phase of the research involved background research, including a thorough literature review in 2002, on how the financial health of governments is defined and assessed. The second phase of the research consisted of surveys of preparers and users of the statistical section of a comprehensive annual financial report (CAFR) and a panel of experts in governmental financial analysis. The research led to the issuance of GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section* in May 2004, which was intended to improve and update the information already being reported about economic condition and its components in the CAFR.

What has the GASB been doing on economic condition reporting since Statement 44?

Since the issuance of Statement 44, the GASB has conducted research regarding whether other types of information are needed to assess economic condition and its components. This third and most recent phase of the economic condition reporting research examined the usefulness of indicators that speak specifically to fiscal sustainability.

What is *fiscal sustainability*?

A number of formal or working definitions of fiscal sustainability and related terms have been developed by standards setters, national governments, and other organizations including the Federal Accounting Standards Advisory Board (FASAB), the International Public Sector Accounting Standards Board (IPSASB), the Australian commonwealth government, the United Kingdom's national government, and the Canadian Institute of Chartered Accountants.

The common themes running through these definitions include the ability: to continue public services and/or existing programs; to meet financial commitments both now and in the future; to maintain the stability and predictability of future tax burdens, which supports informed long-term decision making; to rely on a government's future revenue sources; and to maintain "reasonable" levels of debt.

Is the GASB the first standards setter to study fiscal sustainability?

No. The FASAB has issued Statement 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*, which requires the federal government and its agencies to report fiscal sustainability information that will assist financial report users in assessing whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due. The IPSASB has issued a Consultation Paper, *Reporting on the Long-Term Sustainability of Public Finances*. This due process document seeks feedback on several preliminary views on reporting information about fiscal sustainability.

When and why did GASB add a project to its technical agenda on Economic Condition Reporting: Fiscal Sustainability?

In December 2009, after consultation with fellow GASB members and the members of the Governmental Accounting Standards Advisory Council, GASB Chairman Robert Attmore moved the Economic Condition Reporting: Fiscal Sustainability project from the GASB's Research Agenda to its Current Agenda. Projects on the Current Agenda are those for which active deliberation by the Board is expected to take place during the coming year. Staff work on this project has commenced and deliberations are expected to begin in August 2010.

The project was moved to the Current Agenda for two primary reasons. First, GASB staff research and the findings of other standards setters indicate that the users of state and local government financial reports consider it important to understand a government's past and current economic condition, including how the government arrived at its current status, with an eye toward assessing a government's future financial viability or fiscal sustainability. Second, there have been increasing calls from citizens and their elected representatives for greater transparency and accountability from all levels of government. Considering the current economic downturn, which has created a growing national concern with fiscal sustainability issues at the federal, state, and local levels of government; this is an especially appropriate time to consider the issue of economic condition and fiscal sustainability.

What are the objectives of the GASB project?

The project has three primary objectives: (1) to identify the information that users of governmental financial reports need to assess a governmental entity's fiscal sustainability; (2) to compare those needs with the information that users receive under current accounting and financial reporting standards and from other sources; and (3) to consider reporting alternatives for additional information needed by users. The project also will consider how to communicate any additional information that users need to assess a government's fiscal sustainability, such as in financial statements, notes, required supplementary information, the statistical section, or other forms of supporting information.

Will the GASB project require governments to predict their future financial health?

This project is not about predicting the future; it is about equipping users with the information they need to assess a government's ongoing financial viability. Although the GASB will consider the potential need for projections, the project will focus more generally on information that users need to assess economic condition, including fiscal sustainability.

Where can I get more information?

More information can be found on the Economic Condition Reporting: Fiscal Sustainability project in the Project Pages section of the GASB website at www.gasb.org/project_pages.