NO. 037 | MAY 1987

Governmental Accounting Standards Series

Concepts Statement No. 1 of the Governmental Accounting Standards Board

Objectives of Financial Reporting

GASB

Governmental Accounting Standards Board
of the Financial Accounting Foundation

For additional copies of this Concepts Statement and information on applicable prices and discount rates, contact:

Order Department
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Telephone Orders: 1-800-748-0659

Please ask for Product Code No. GC01.

The GASB website can be accessed at www.gasb.org.

Summary

This concepts Statement establishes the objectives of general purpose external financial reporting by state and local governmental entities and applies to both governmental-type and business-type activities.

Governmental financial reporting objectives are influenced by the characteristics of the state and local governmental operating environment and by the needs of those who use governmental financial reports. The activities of governmental entities have traditionally been divided into two categories—governmental-type activities and business-type activities.

The significant characteristics of the governmental environment that affect financial reporting of governmental-type activities and that need to be considered when establishing financial reporting objectives are:

a. Primary characteristics of government's structure and the services it provides:
   (1) The representative form of government and the separation of powers
   (2) The federal system of government and the prevalence of intergovernmental revenues
   (3) The relationship of taxpayers to services received
b. Control characteristics resulting from government's structure:
   (1) The budget as an expression of public policy and financial intent and as a method of providing control
   (2) The use of fund accounting for control purposes
c. Other characteristics:
   (1) The dissimilarities between similarly designated governments
   (2) The significant investment in non-revenue-producing capital assets
   (3) The nature of the political process.

The Board has identified three groups as the primary users of external state and local governmental financial reports: the citizenry, legislative and oversight bodies, and investors and creditors. Financial reports are used primarily to compare actual financial results with the legally adopted budget; to assess financial condition and results of operations; to assist in determining compliance with finance-related laws, rules, and regulations; and to assist in evaluating efficiency and effectiveness.

Governmental business-type activities frequently operate in an environment that differs to a certain extent from the environment in which governmental-type activities operate. For example, business-type activities are generally characterized by an exchange relationship, manifested by user charges that may be based on the costs of providing a particular service. On the other hand, some business-type activities receive significant

operating subsidies, capital grants, or taxes from the general government, diminishing the role of costs in establishing user charges. All governmental business-type activities, whether performed through separate, legally constituted entities or as departments of government, are nevertheless a part of government and are publicly accountable. The Board concluded, therefore, that the financial reporting objectives established for governmental-type activities are generally applicable to business-type activities. Environmental and user need differences will be taken into account in developing specific financial reporting standards.

The Board believes that financial reporting plays a major role in fulfilling government's duty to be publicly accountable in a democratic society. Public accountability is based on the belief that the taxpayer has a "right to know," a right to receive openly declared facts that may lead to public debate by the citizens and their elected representatives. Use of financial reporting by citizens and legislative and oversight officials to assess accountability is pervasive and is implied in the uses noted above. The Board also believes that financial reporting should provide information to assist users in assessing interperiod equity by showing whether current-year revenues are sufficient to pay for current-year services or whether future taxpayers will be required to assume burdens for services previously provided.

State and local governmental financial reports should possess these basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability.

The financial reporting objectives set forth in this concepts Statement (which are best understood in the context of the full Statement) are:

a. Financial reporting should assist in fulfilling government's duty to be publicly accountable and should enable users to assess that accountability by:
    (1) Providing information to determine whether current-year revenues were sufficient to pay for current-year services
    (2) Demonstrating whether resources were obtained and used in accordance with the entity's legally adopted budget, and demonstrating compliance with other finance-related legal or contractual requirements
    (3) Providing information to assist users in assessing the service efforts, costs, and accomplishments of the governmental entity
b. Financial reporting should assist users in evaluating the operating results of the governmental entity for the year by:
    (1) Providing information about sources and uses of financial resources
    (2) Providing information about how it financed its activities and met its cash requirements

(3) Providing information necessary to determine whether its financial position improved or deteriorated as a result of the year's operations

c. 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:

1) Providing information about its financial position and condition

(2) Providing information about its 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

(3) Disclosing legal or contractual restrictions on resources and the risk of potential loss of resources.

Concepts Statement No. 1 of the
Governmental Accounting
Standards Board

Objectives of Financial Reporting

May 1987

Governmental Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116

Concepts Statement No. 1 of the Governmental Accounting Standards Board

Objectives of Financial Reporting

May 1987

CONTENTS

Paragraph
Numbers

Preface

This concepts Statement establishes the objectives of external financial reporting by state and local governmental entities. These objectives provide the framework within which the Board develops standards of financial reporting for governmental entities.

The Board recognizes that developing and implementing standards to accomplish certain objectives may take longer than others because of the time needed to establish information-gathering systems and to gain experience by experimenting with alternative approaches. In addition, the Board expects that some of these objectives may be best accomplished through means of reporting other than the basic financial statements, and possibly through means of reporting outside the comprehensive annual financial report. In developing specific standards, the Board will consider the needs of users and the usefulness of the information in relation to the cost of developing and providing it.

The standards-setting process benefits most from the guidance provided by this Statement. However, knowledge of these objectives should enable preparers and users of governmental financial reports to better understand the content and limitations of financial reports and should enhance user confidence in governmental financial reporting.

The Board acknowledges that objectives are affected by the economic, legal, social, and political environment and may change as the environment changes. Like other pronouncements of the Board, this Statement may be amended, superseded, or withdrawn by appropriate action under the Board's *Rules of Procedure.* Unlike other Board Statements, this concepts Statement does not establish standards of governmental accounting and financial reporting.

The Board recognizes that, in certain respects, existing generally accepted accounting principles (GAAP) may be inconsistent with those that may be derived from these objectives. However, in due course, the Board expects to reexamine pronouncements of predecessor standards-setting bodies and existing financial reporting practices in light of these objectives. In the meantime, this Statement does not (a) require a change in existing GAAP, (b) amend, modify, or interpret existing GAAP, or (c) justify either changing existing GAAP or applying existing GAAP based on personal interpretations of these objectives.

Establishing objectives and concepts will not, in itself, directly solve financial reporting problems. Rather, objectives define the framework within which solutions may be found.

Concepts Statement No. 1 of the Governmental Accounting Standards Board

Objectives of Financial Reporting

May 1987

PURPOSE AND SCOPE

1. This Statement establishes objectives of external financial reporting by state and local governmental entities. It supersedes Concepts Statement 1, *Objectives of Accounting and Financial Reporting for Governmental Units* (1982), issued by the National Council on Governmental Accounting.[1]

2. This Statement does not establish governmental financial reporting standards; rather, it describes concepts that will be used by the Board as a framework for evaluating existing standards and practices and for establishing future financial reporting standards. It broadly describes the nature of information needed by users of external governmental financial reports and gives consideration to the governmental environment.

3. Financial reporting is not an end in itself but is intended to provide information useful for many purposes. Financial reporting helps fulfill government's duty to be publicly accountable. Financial reporting also helps to satisfy the needs of users who have limited authority, ability, or resources to obtain information and who therefore rely on the reports as an important source of information. For that purpose, financial reporting objectives should consider the needs of users and the decisions they make.

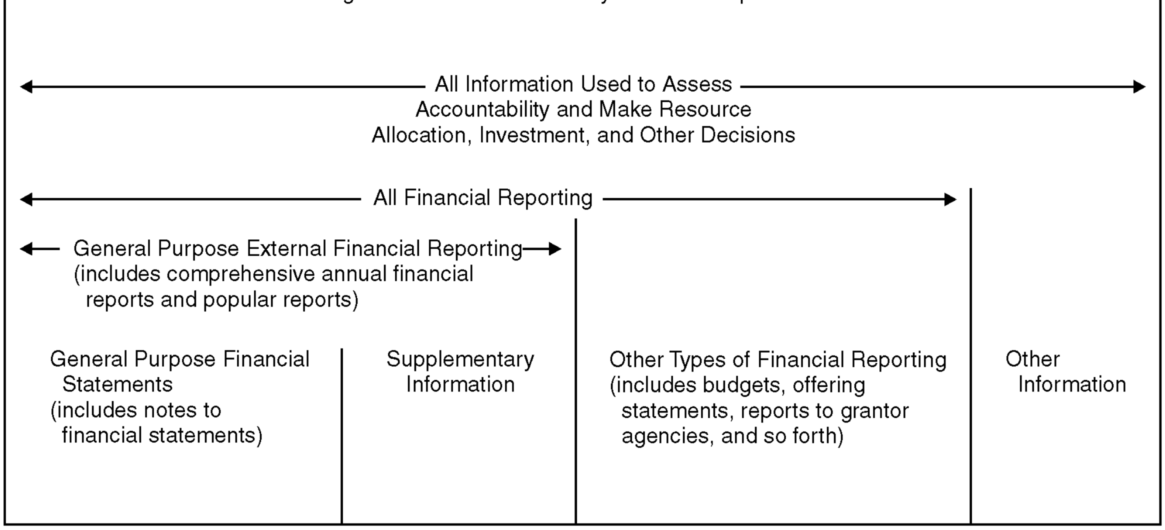
4. Financial reporting is a means of communicating financial information to users. It encompasses all reports that contain financial information based on data generally found in financial statements. Financial reports and financial statements are end products of the reporting process. Certain information is better provided by financial statements; other information is better provided, or can only be provided, by financial reporting outside the financial statements. But financial reporting is not the only source of financial information about governmental entities. In many cases, users of financial reports also need to consult other sources to completely satisfy their information needs.

---

[1]Because the scope of NCGA Concepts Statement 1 includes accounting as well as financial reporting objectives, the GASB considers it to be a useful reference and will continue to include it in an appendix to the GASB *Codification of Governmental Accounting and Financial Reporting Standards.*

5. Figure 1 illustrates (a) the role of financial reporting in providing information used to assess accountability and make decisions and (b) the role of financial statements within the overall range of financial reporting by state and local governments. This illustration also outlines the scope of this Statement by distinguishing between *general purpose external financial reporting* and other types of financial reporting.

Figure 1: Information Used by Financial Report Users



6. *Financial statements* are the core of financial reporting and are the principal means of communicating financial information to external users. Governmental *general purpose financial reporting* includes, in addition to general purpose financial statements (GPFS), "popular reports" and comprehensive annual financial reports (CAFRs). Popular reports are less detailed and are often intended for users whose financial reporting needs are better satisfied through more condensed information; CAFRs are more detailed and are intended for users who need a broad range of information. Both popular reports and CAFRs may include such nonfinancial information as statistical data, analytical data, demographic information, forecasts, economic and service delivery statistics, legally required data, narrative explanations, and graphic displays.

7. Government officials often choose, or are required, to report through *other types of financial reporting*. Offering statements, budgets, and reports filed with federal grantor agencies or senior levels of government are examples of other types of financial reporting and may include financial statements, other financial information, and nonfinancial

information. They are also examples of *special purpose financial reporting.* Special purpose financial reporting is generally used to satisfy the specific needs of specific users, while general purpose external financial reporting provides information to meet the common needs of various users. Often, special purpose report users have statutory authority or other ability to require a governmental entity to issue reports that meet their needs, and they do not have to rely solely on information in general purpose external financial reporting. Special purpose reports are generally used to (a) meet specific legal or contractual requirements, (b) present financial statements using a basis of accounting that differs from generally accepted accounting principles, (c) present financial information in prescribed formats, or (d) report on specified elements, accounts, or items taken from the general purpose financial statements.

Scope of This Statement

8. The Board takes a broad view of public accountability and anticipates that not all financial reporting objectives of state and local governmental entities can be accomplished through general purpose financial statements. Accordingly, the financial reporting objectives in this Statement pertain to *general purpose external financial reporting* and are not restricted to information reported in the GPFS. That is, not every standard the Board issues will be limited to a GPFS requirement. Board standards may, for example, be established for data to be included in the statistical section of a CAFR if the Board believes that information is helpful in fulfilling government's duty to be accountable.

9. The financial reporting objectives in this Statement may not necessarily meet the needs of users who can require governmental entities to issue special purpose financial reports. However, special purpose financial reports may contain, in addition to specially required information, general purpose financial statements and other financial information. The standards the Board establishes to accomplish the financial reporting objectives in this Statement apply to general purpose financial statements and other general purpose financial information presented in special purpose financial reports.

Applicability to Governmental-Type and Business-Type Activities

10. Governmental activities have traditionally been divided into two categories—governmental-type activities and business-type activities. Governmental-type activities are performed by general purpose governmental entities such as states, cities, counties, towns, and villages, as well as by certain special purpose governmental entities. Governmental entities perform business-type activities both through departments of general purpose governmental entities and through special purpose governmental entities created to perform these activities.

11. It is often difficult to draw a clear distinction between the two types of activities. For example, some business-type activities (such as mass transit operations and some hospitals) may be so heavily subsidized by government that they also take on some of the characteristics of governmental-type activities. The objectives set forth in this Statement are intended to apply to both governmental and business-type activities, whether their financial operations are reported in separately issued reports or within the general purpose external financial report of the broader governmental entity.

GOVERNMENTAL-TYPE ACTIVITIES

The Governmental Environment

12. An organization's operating environment necessarily influences its financial reporting objectives. The state and local governmental environment is complex and cannot be described in a single phrase or understood by considering any single factor. Understanding the fundamental nature of government as well as the significant characteristics of its environment is essential to determining its financial reporting objectives.

13. The significant characteristics of the governmental environment that affect financial reporting and that need to be considered in establishing financial reporting objectives are listed below and discussed in the paragraphs that follow.

a. Primary characteristics of government's structure and the services it provides:
   (1) The representative form of government and the separation of powers
   (2) The federal system of government and the prevalence of intergovernmental revenues
   (3) The relationship of taxpayers to services received
b. Control characteristics resulting from government's structure:

(1) The budget as an expression of public policy and financial intent and as a method of providing control
(2) The use of fund accounting for control purposes

c. Other characteristics:
(1) The dissimilarities between similarly designated governments
(2) The significant investment in non-revenue-producing capital assets
(3) The nature of the political process.

The Representative Form of Government and the Separation of Powers

14. In a representative democracy, power ultimately rests in the hands of the citizenry. The citizens delegate that power to public officials through the election process. Accompanying this delegation of power in America is a system of separation of powers among the executive, legislative, and judicial branches of government—a system intended to provide "checks and balances" over the potential abuse of power by the citizens' representatives.

15. As applied to state and local governmental finance generally, the executive branch prepares a budget and submits appropriation requests to the legislative branch. The legislative branch has the power to approve those requests, authorizing the executive branch to make expenditures within the limits of the appropriations and any laws that may affect programs covered by those appropriations. The executive branch is accountable to the legislative branch for operating within those appropriations and laws, and both branches are accountable to the citizenry.

The Federal System of Government and the Prevalence of Intergovernmental Revenues

16. There are three levels of government under the American federal system: federal, state, and local governments. The ability of higher levels of government to encourage or dictate activities undertaken by lower levels of government and to raise revenues over broader tax bases has resulted in extensive intergovernmental grants and subsidies. Often, the government receiving intergovernmental revenues is the final recipient. In other cases, however, the receiving government is an intermediary responsible for distributing the funds to other governments at its discretion or according to the requirements of the grantor (pass-through funding). Grants and other forms of intergovernmental revenues as well as pass-through funding require state and local governments to be accountable to the governmental entity providing the resources, as well as to the citizenry.

The Relationship of Taxpayers to Services Received

17. Essentially, governments impose taxes and provide services. In certain instances, governments charge fees for services rendered, and in these instances there may be a direct relationship between the fees paid and the services received. Most governmental revenues, however, come from taxes, and, even when fees are charged for services, those fees are sometimes supplemented with tax revenues. Taxes imposed and services provided by governments possess certain characteristics that need to be considered when developing financial reporting objectives:

a. Taxpayers are involuntary resource providers; they cannot choose whether or not to pay taxes, even if they do not receive or take advantage of all services provided.
b. The amount of taxes paid by an individual generally depends on the value of property owned, income earned, and so forth, and seldom bears a proportional relationship to the cost or value of the services received by that individual.
c. There is no "exchange" relationship between resources provided and services received. Most individual taxes do not pay for specific services, even though individual taxes or portions of taxes are sometimes dedicated to particular activities. Instead, governments generally use resources from a variety of sources to pay for a variety of services. The "matching" relationship that normally exists between resources provided and services received is a timing relationship (that is, both occur during the fiscal year) rather than an exchange relationship.
d. Governments often have a monopoly on the services they provide to the public. This does not necessarily mean that only governments can provide certain services; indeed, some governments provide services that are provided by private enterprises elsewhere. When there is a lack of a competitive marketplace, it becomes more difficult to measure efficiency in providing those services.
e. It is extremely difficult to measure optimal quantity or quality for many of the services provided by government. How many police are "enough"? What is a "reasonable" student-teacher ratio? This problem is complicated by the involuntary nature of the resources provided. For example, a consumer purchasing a commercial product can determine how much to purchase and may choose among "good," "better," and "best" quality and pay accordingly. A group of individuals paying for governmental services (and paying in different proportions for services that some of them may not use or desire) presents a far more complex situation.

18. These characteristics highlight the need for public accountability in governmental financial reporting. In private-sector business enterprises, the direct relationship between revenues earned and costs incurred allows the financial statement user to assess performance based primarily on profitability. In government there is no single overall performance measure such as net income or earnings per share. The user of governmental financial reports must therefore assess accountability by evaluating performance through a

variety of measures. As a result, governmental accountability requires means of financial reporting that differ from private-sector business enterprise financial reporting.

The Budget as an Expression of Public Policy and Financial Intent and as a Method of Providing Control

19. Many believe the budget is the most significant financial document produced by a governmental entity. The budget has been defined as a plan for the coordination of revenues and expenditures or as the amount of money that is available for, required for, or assigned to a particular purpose. Most governments have annual operating budgets that are legally adopted. Although often not required by law, some governments also prepare long-term operating budgets and capital budgets. Long-term budgets are "master plans" for the operation of a government for periods longer than one year. Capital budgets are plans for proposed capital outlays and the means of financing them. The focus of this discussion, however, is on the legally adopted annual budget, which, by its nature, has significant financial reporting implications:

a. It is an expression of *public policy.* Budgets result from the legislative process and require resolution of conflicting views about the way in which and extent to which financial resources will be raised and used. The citizenry participates in the budget process either directly or indirectly, through elected representatives or advocate groups. Once adopted, the budget is a formal expression of public policy on the entity's objectives and priorities and on how resources will be provided to meet those objectives.
b. It is a financial plan, or an expression of *financial intent.* It sets forth the proposed expenditures for the year and the means of financing them. Statutes and local ordinances often require or imply a "balanced budget," even though the term may not be precisely defined. There is also a common perception that state and local governments need to "live within their means," a logical implication of the balanced-budget concept.
c. It is a form of *control* usually having the force of law. A legally adopted budget provides both *authorizations of* and *limitations on* amounts that may be spent for particular purposes. Because budgetary authorizations result from competition for scarce resources and budgetary limitations generally cannot be exceeded without due process, the governmental entity needs to demonstrate that it is accountable from both the authorization and the limitation perspectives.
d. It may provide a basis for *evaluating performance.* Comparisons of actual results to the legally adopted budget can provide information to help users assess whether resources were obtained and expended as anticipated. Detailed performance evaluation, however, requires the government to establish service efforts and accomplishment goals and to accumulate actual data for comparison purposes.

20. Budgetary expression of public policy, financial intent, control, and performance measures need to be considered when developing financial reporting objectives, even though financial accounting concepts of inflows and outflows may differ from budgetary concepts.

The Use of Fund Accounting for Control Purposes

21. Certain control mechanisms have evolved to ensure that resources provided are used as intended. One mechanism, described earlier, is the budget. Another is the governmental fund structure. Some funds are created by law (local ordinance), others by covenant (bond indentures), and still others by management decision to enhance financial administration.

22. The use of fund accounting as a control mechanism needs to be considered when developing financial reporting objectives. The financial and legal requirements and restrictions leading to fund accounting need to be considered as part of government's duty to be accountable, in a manner that does not obscure presentation of results of operations and financial position of the entity as a whole.

The Dissimilarities between Similarly Designated Governments

23. The fact that governmental entities have similar designations (states, cities, counties, towns) throughout the country does not necessarily mean that they are similar organizations or that they perform the same functions. In some states a particular function may be performed by a county; in others it may be performed by a city or the state. In some cities a service may be provided by a department of the city government; in others it may be provided by a specially created district or public authority. In some cases a specially created entity may serve some or all of the residents of a single general purpose government; in other cases a joint venture may serve the residents of several general purpose governments. Even within a single state, a given function may be performed either by a city or by a special district serving several cities and towns.

24. Sometimes, a special district or authority may be authorized to finance construction by issuing debt backed solely by its operating revenues; sometimes the debt may also be backed by the full faith and credit or "moral obligation" of the state, city, or county. Some special districts or authorities may be entirely self-sufficient; others may be financially dependent on the governments that created them.

25. The ability to produce comparable data is affected by the fact that similar levels of government may (a) perform different functions or (b) perform similar functions in separately created districts or authorities. Financial reporting should consider the nature of the relationship between governmental entities and the agencies they create. Differences in the organization of governmental entities, the services they provide, and their sources of revenues all need to be considered when developing financial reporting objectives.

The Significant Investment in Non-Revenue-Producing Capital Assets

26. Governmental entities invest large amounts of resources in non-revenue-producing capital assets such as government office buildings, highways, bridges, and sidewalks. Most governmental capital assets have relatively long lives, and an adequate program of maintenance and rehabilitation is needed to ensure that those estimated useful lives will be realized. That is, governments, in essence, have an implicit commitment to maintain their capital assets, whether or not they are used directly to produce revenues.

27. Governmental entities must maintain revenue-producing capital assets (a water pumping station, for example) to continue to generate that revenue. However, maintenance of non-revenue-producing capital assets (roads and bridges, for example) usually bears a less direct relationship to the revenue-raising capabilities of a government. Maintenance programs for non-revenue-producing capital assets can be altered, suspended, or even ignored because of the competition for limited resources. Government’s implicit commitment to maintenance and its ability to delay maintenance and rehabilitation expenditures, especially for non-revenue-producing capital assets, need to be considered when developing financial reporting objectives.

The Nature of the Political Process

28. One of government’s primary goals is to promote the general welfare of all of its citizens. While in the private sector a financial objective may be to maximize the shareholder return on investment, state and local governments attempt to achieve budgetary equilibrium, by balancing taxes and other financial resources with the needs of its citizens. One of the major difficulties of the governmental political process is that it must reconcile the often-conflicting, virtually unlimited wants of the citizenry with the resources made available by the citizenry. That difficulty results partly from a fact noted in the discussion of taxpayers: The amount of taxes paid by an individual taxpayer seldom

bears a proportional relationship to the aggregate cost or the perceived value of the services received by that taxpayer.

29. The objective of the citizenry is to obtain the maximum amount of service with a minimum amount of taxes. It is possible for the citizens' elected representatives to satisfy certain service needs by deferring others, to pay for an increased level of services with nonrecurring revenues, and to defer the cash effect of events, transactions, and circumstances that occur in a particular period. The potential for these practices is increased by the fact that those representatives serve for relatively short terms and tend to take a short-term outlook. Accordingly, the appearance of budgetary equilibrium may not be true equilibrium. Therefore, to help fulfill a government's duty to be accountable, financial reporting should enable the user to assess the extent to which operations were funded by nonrecurring revenues, or long-term liabilities were incurred to satisfy current operating needs.

Users of Financial Reports

30. The Board believes there are three groups of primary users of external state and local governmental financial reports. They are (a) those to whom government is primarily accountable (the citizenry), (b) those who directly represent the citizens (legislative and oversight bodies), and (c) those who lend or who participate in the lending process (investors and creditors). The needs of intergovernmental grantors and other users are considered to be encompassed within the needs of the three primary user groups. Internal managers in the executive branch of government who have ready access to financial data through *internal* reporting are not considered *primary* users for purposes of this Statement; however, internal users also have many uses for external financial reports. Many who use special purpose financial reports also rely on general purpose external financial reporting.

31. The citizenry group includes citizens (whether they are classified as taxpayers, voters, or service recipients), the media, advocate groups, and public finance researchers. The legislative and oversight officials group includes members of state legislatures, county commissions, city councils, boards of trustees, and school boards, and those executive branch officials with oversight responsibility over other levels of government. Investors and creditors include individual and institutional investors and creditors, municipal security underwriters, bond rating agencies, bond insurers, and financial institutions.

Uses of Financial Reports

32. Financial reporting by state and local governments is used in making economic, social, and political decisions and in assessing accountability primarily by:

a. Comparing actual financial results with the legally adopted budget
b. Assessing financial condition and results of operations
c. Assisting in determining compliance with finance-related laws, rules, and regulations
d. Assisting in evaluating efficiency and effectiveness.[2]

Comparing Actual Financial Results with the Legally Adopted Budget

33. All three user groups are interested in comparing original or modified budgets with actual results. For example, to assess accountability, citizens and legislative and oversight bodies want to ensure that resources were used in accordance with appropriations. Spending in excess of budgeted amounts may indicate poor financial management, weak budgetary practices, or uncontrollable, unforeseen circumstances. Underspending may indicate that there was effective cost containment, that the quality or quantity of services could have been increased within available appropriations, that actions were taken to achieve a budget surplus, or that resources were overbudgeted for a particular program.

Assessing Financial Condition and Results of Operations

34. Financial reports are commonly used to assess a state or local government's financial condition, that is, its financial position and its ability to continue to provide services and meet its obligations as they come due. Assessing an entity's results of operations for current and previous years provides each user group with information that is useful in a variety of ways. The reasons for making that assessment, however, may differ from group to group.

35. Investors and creditors need information about available and likely future financial resources, actual and contingent liabilities, and the overall debt position of a government to evaluate the government's ability to continue to provide resources for long-term debt service. They review operating results and cash flow data (both currently and over time) to look for trends that may indicate strengths and weaknesses in the ability of the

[2]This discussion of users and uses of governmental general purpose external financial reporting is based in part on the October 1985 GASB staff Research Report, *The Needs of Users of Governmental Financial Reports.*

government to repay debt. Trend analysis helps investors and creditors project future revenues and predict possible allocation of those revenues.

36. Citizens' groups are concerned with financial condition when evaluating the likelihood of tax or service fee increases. They are also concerned with the sources and uses of resources; for example, information on inflows from intergovernmental grants is particularly important when considering the effect of an anticipated reduction in federal or state grants. Citizens, particularly special-interest groups, use governmental financial reports for advocacy purposes. For example, information that could be used to forecast revenues would be helpful to citizens' advocate groups urging increases in expenditures for specific functions, such as education or transportation.

37. Legislative and oversight officials need to assess the overall financial condition, including debt structure and funds available for appropriation, when developing both capital and operating budget and program recommendations. They monitor operating results both currently and over time to assure compliance with program mandates. Legislators are concerned with the level and sources of resources and the level and types of spending. This information helps them decide on the reasonableness of fees, the need for tax increases or reductions, and the ability to finance program expansions and capital needs without raising taxes.

38. Governmental financial reports are also used by various groups to compare amounts spent on similar functions by other governments. For example, a county board member may compare the amount of resources spent on soil conservation in the county with that spent by surrounding counties. State legislators make comparisons among municipalities to assist in allocating resources to those municipalities. To influence spending priorities, citizens may compare amounts spent in their community with that spent in similar communities.

Assisting in Determining Compliance with Finance-Related Laws, Rules, and Regulations

39. In addition to the legally mandated budgetary and fund controls, there may be other legal restrictions controlling governmental actions. Some examples are bond covenants, grant restrictions, and taxing and debt limits. Financial reports help demonstrate compliance with these laws, rules, and regulations. Citizens are concerned that governments adhere to these regulations because noncompliance may indicate fiscal

irresponsibility and could have severe financial consequences such as acceleration of debt payments, disallowance of questioned costs, or loss of grants.

40. Legislative and oversight officials are also concerned with compliance as a follow-up to the budget formulation process. For instance, state legislators are concerned that state agencies and local jurisdictions comply with state mandates for use of funds provided. Grantor agencies, such as the federal government, have placed increased reliance on state and local governmental financial reporting, and auditing of those reports, to assure that grant requirements have been met. Elected officials need to determine compliance with the legally adopted budget.

41. Investors and creditors are interested in government's compliance with debt covenants and restrictions designed to protect their investment. Many of these legal restrictions are imposed by the creditors themselves to provide adequate reserves against economic downturns.

Assisting in Evaluating Efficiency and Effectiveness

42. Citizen groups and legislators, in particular, want information about service efforts, costs, and accomplishments of a governmental entity. This information, when combined with information from other sources, helps users assess the economy, efficiency, and effectiveness of government and may help form a basis for voting or funding decisions. To be of value, the information needs to be sufficiently detailed to permit comparisons with other years and other governmental entities. Grantor agencies, including higher levels of government, are also concerned with the efficient and effective use of grant funds.

BUSINESS-TYPE ACTIVITIES

The Environment

43. Governments frequently engage in business-type activities. Those activities resemble private-sector business activities not only because they provide the same services as private-sector businesses but also because there is an exchange relationship between the provider and the consumer: The consumer is charged for services rendered. Some bear a further resemblance to private-sector business activities because they are self-sufficient and operate as separate, legally constituted organizations. Others more closely resemble governmental-type activities because they are regularly subsidized by taxes or are operated

as departments within a government. Despite differences, governmental business-type activities are nevertheless a part of government, subject to the same public accountability requirements as governmental-type activities. The paragraphs that follow discuss the similarities and differences in the operating environments of governmental-type activities and governmental business-type activities.

The Relationship between Services Received and Resources Provided by the Consumer

44. As noted in paragraph 17, the resources raised by general government are usually not derived from the specific services rendered. For example, there is no specific charge for public safety services; they are financed along with many other services from general property or income taxes. For business-type activities, however, there is often a direct relationship between the charge and the service itself. That relationship is termed an "exchange relationship"—a user fee is charged for a specific service provided; for example, a toll for use of a road, a charge for water, or a fare to ride the bus.

45. This exchange relationship causes users of financial reports to focus on measuring the costs (or resource outflows, or both) of providing the service, the revenues obtained from the service, and the difference between the two. Measuring both the cost of services and resource outflows is useful. Whether one is more important than the other depends on various factors, including the way in which user charges are calculated and whether or not subsidies are provided by general government.

46. Cost-of-services information is useful for public policy decisions. For example, the amount a business-type activity charges users for its services may be based on recovery of all costs. In other cases, capital assets may be provided by direct subsidies (general government or intergovernmental grants) and therefore may not be included in calculating user charges. However, in both cases, financial statement users need to know the full cost of operating the business-type activity, and the financial implications of the subsidies or grants need to be understood. At the same time, information about resource flows is also useful, particularly when user charges are based on resource flows, rather than costs. Subsidies from general government may also be based on net cash outflows rather than on net operating deficit after depreciation.

Revenue-Producing Capital Assets

47. Most capital assets of business-type activities are revenue producing. For example, user charges for a toll road are usually based directly on the cost to construct (or finance) and maintain that road. The capital assets of many governmental-type activities, by contrast, do not have a direct relationship to the government's revenue-raising capabilities. Therefore, the incentive for business-type activities to defer needed maintenance may not be as great as that for governmental-type activities. When business-type activities receive general government subsidies, however, they need to compete for funds with governmental-type activities and are subject to the same constraints. Regardless of how they are financed, many business-type activities are capital intensive, and the need for information concerning those assets needs to be considered when developing financial reporting objectives.

Similarly Designated Activities and Potential for Comparison

48. Governmental business-type activities often perform only a single function. If the function is supplying water, for example, the problems, procedures, and cost components of obtaining, treating, and delivering it are similar, regardless of whether the function is performed by a private-sector business, a public authority, or an enterprise fund or as part of a broader government's general fund. As a result, there is frequently a greater potential for comparability among business-type activities performing similar functions than among governmental-type activities, which vary from government to government.

The Nature of the Political Process

49. Some governmental business-type activities are designed to be insulated from the political process—they are not part of the general governmental budgetary process, they have a direct relationship between fees and services rendered, and they are separate legally constituted agencies. In some instances, however, this insulation from the political process has less substance than appearances suggest. Especially in subsidized activities, rate setting, even by independent boards, is political in nature. For example, mass transit user charges sufficient to pay all the costs of the system may be politically or economically undesirable, so that subsidies are often provided from general tax revenues or grants from other jurisdictions. Once operating or capital subsidies are provided, the influences of the political process discussed in paragraphs 28 and 29 become just as significant as in governmental-type activities.

Budgets and Fund Accounting

50. The use of legally adopted budgets and fund accounting is less common for business-type activities than for governmental-type activities. Unless the business-type activity is operated as a governmental department, the review and adoption process and legal status of the budget may be different. For many business-type activities the budget represents essentially an internal management process, lacking the force of law. Similarly, because business-type organizations often perform a single function, fund accounting is not as common as it is in governmental-type activities. However, it is sometimes used as a result of bond agreements to provide controls for the protection of bondholders.

Users and Uses of Financial Reports

51. In general, the users and uses of governmental financial reports are essentially the same regardless of whether the activity is business-type or governmental-type. Some users' needs are better satisfied by separate reports of the business-type activity; others' needs can only be satisfied by using the reports of the broader general government.

52. Although this Statement does not consider executive branch personnel of general purpose governments to be primary users of external financial reports of governmental-type activities, those personnel often become more like external users when governmental business-type activities are organized separately from the governments that oversee them. When business-type activities are subsidized by direct appropriations from general government, day-to-day relationships between executive branch personnel and the business-type activity are often similar to that of other departments. But as the financial relationships become more remote, external financial reporting becomes increasingly important to the executive branch in monitoring the activities and the management of business-type activities.

53. The uses of financial reports of business-type activities generally differ only in *emphasis* from the uses of financial reports of governmental-type activities. Users of separate financial reports of business-type activities are concerned primarily with the financial condition and results of operations for that activity; they are often not concerned with comparing actual results with budgeted amounts. Investors and creditors are concerned primarily with whether the business-type activity is generating, and will continue to generate, sufficient cash to meet debt service requirements. Citizen groups and consumers use results of operations information primarily to assess the reasonableness of user charges. Legislative and oversight officials and executive branch officials review

financial reports of business-type activities from both perspectives. Depending on their legal relationships with the business-type activity, legislative and oversight officials also use financial reports to assess the potential need to subsidize the activity with general governmental revenues, or whether the general government may obtain access in some manner to the net cash flows generated by the activity. They may also want to compare actual results with budgets they have approved.

54. Investors and creditors are just as concerned with compliance with bond provisions by business-type activities as they are for governmental-type activities. Citizens' groups and legislative and oversight officials need information about effectiveness, economy, and efficiency, particularly because that information has an effect on user charges.

55. Users of a broader general government's financial report are generally concerned with the relationship between the financial position and operating results of the business-type activity and that of the general government as a whole. Those users need to determine to what extent the business-type activity depends on the general government's financial support or to what extent the general government has access to that activity's resources.

ACCOUNTABILITY AND INTERPERIOD EQUITY

Accountability

56. Accountability is the cornerstone of all financial reporting in government, and the term *accountability* is used throughout this Statement. The dictionary defines *accountable* as "being obliged to explain one's actions, to justify what one does." Accountability requires governments to answer to the citizenry—to justify the raising of public resources and the purposes for which they are used. Governmental accountability is based on the belief that the citizenry has a "right to know," a right to receive openly declared facts that may lead to public debate by the citizens and their elected representatives. Financial reporting plays a major role in fulfilling government's duty to be publicly accountable in a democratic society.

57. The Board is aware that applying the broad concept of public accountability to financial reporting by state and local governments creates the potential to extend reporting beyond current practice. If being accountable means being obliged to explain one's actions, what are the limits of disclosure? How does one balance the cost of providing information against the value of the public's "right to know"? The need to be accountable

for resources provided involuntarily by taxpayers makes cost-benefit analysis particularly difficult in setting standards. In addition, the benefits of financial information are usually difficult or impossible to measure objectively, particularly in a governmental environment.

58. The Board believes that, at a minimum, demonstrating accountability through financial reporting includes providing information to assist in evaluating whether the government was operated within the legal constraints imposed by the citizenry. The structure of government, the nature of the resource providers, and the political process are characteristics of the environment that underscore the need for accountability.

Interperiod Equity

59. The laws of most governments require balanced budgets. The intent of these laws is to require financing and spending practices that enable governmental entities to avoid financial difficulty and to "live within their means." Similarly, the laws of many states require governmental debt to be repaid over a period no greater than the period of probable usefulness of the capital asset acquired with the debt. Balanced budget and debt limitation statutes are examples of laws designed to achieve fairness from one year, one term of office, or one generation to another. In practice, however, partly because of the lack of precision in defining what constitutes resource inflows and outflows, fairness is not always achieved. In fact, the appearance of balance may be misleading in some cases.

60. The Board believes the intent of balanced budget laws is that the current generation of citizens should not be able to shift the burden of paying for current-year services to future-year taxpayers. Recently, the term *intergenerational equity* has been used to express this concept. However, because a generation is defined as approximately 30 years and because the term *intergenerational equity* has implications that go beyond financial reporting, the Board believes the term *interperiod equity* may be more appropriate, expressing the concept of yearly balance.[3]

61. The Board believes that interperiod equity is a significant part of accountability and is fundamental to public administration. It therefore needs to be considered when establishing financial reporting objectives. In short, financial reporting should help users assess whether current-year revenues are sufficient to pay for the services provided that

---

[3]For governments that prepare biennial budgets, interperiod equity encompasses that two-year period. Multiyear information may also be used to assess interperiod equity over the longer term.

year and whether future taxpayers will be required to assume burdens for services previously provided.

CHARACTERISTICS OF INFORMATION IN FINANCIAL REPORTING

62. Financial reporting is the means of communicating financial information to users. For this communication to be effective, information in financial reports must have these basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability.[4]

Understandability

63. Information in financial reports should be expressed as simply as possible. Users of governmental reports tend to have different levels of knowledge and sophistication about governmental accounting and finance. To be publicly accountable, a government should issue financial reports that can be understood by those who may not have a detailed knowledge of accounting principles. Those reports should include explanations and interpretations that help users understand the information provided. However, financial reporting should not exclude information merely because it is difficult to understand or because some users choose not to use it.

Reliability

64. Financial reporting should be reliable; that is, the information presented should be verifiable and free from bias and should faithfully represent what it purports to represent. To be reliable, financial reporting needs to be comprehensive. Nothing material should be omitted from the information necessary to faithfully represent the underlying events and conditions, nor should anything be included that would cause the information to be misleading. Reliability does not imply precision or certainty. Reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured; financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances some financial information is based on reasonable estimates. A properly explained estimate provides more meaningful information than no estimate at all.

---

[4] The essential characteristics of information in financial reports and the limitations of financial reporting, as they appear in paragraphs 63–73 of this Statement, are discussed in detail in FASB Concepts Statements No. 1, *Objectives of Financial Reporting by Business Enterprises, and No. 2, Qualitative Characteristics of Accounting Information.* Readers interested in a more detailed discussion of these issues are referred to those two FASB Statements.

Relevance

65. Relevance encompasses many of the other characteristics; for example, if the information provided in a financial report is not timely or reliable, it is not relevant. Information can, however, meet all other characteristics and still not be relevant. To be relevant there must be a close logical relationship between the information provided and the purpose for which it is needed. Information is relevant if it is capable of making a difference in a user's assessment of a problem, condition, or event. Relevance depends on the types of financial information needed by the various users to make decisions and assess accountability.

Timeliness

66. If financial reports are to be useful, they must be issued soon enough after the reported events to affect decisions. Timeliness alone does not make information useful, but the passage of time usually diminishes the usefulness that the information otherwise would have had. In some instances, timeliness may be so essential that it may require sacrificing a certain amount of precision or detail. Sometimes a timely estimate is more useful than precise information that takes a long time to produce.

Consistency

67. Financial reports should be consistent over time; that is, there is a presumption that once an accounting principle or reporting method is adopted, it will be used for all similar transactions and events. The concept of consistency in financial reporting extends to many areas such as valuation methods, basis of accounting, and determination of the financial reporting entity. If accounting principles have been changed or the financial reporting entity has changed, the nature and reason for the change as well as the effect of the change should be disclosed.

Comparability

68. Financial reports should be comparable. This does not imply that similarly designated governments perform the same functions. Comparability implies that differences between financial reports should be due to substantive differences in the underlying transactions or the governmental structure rather than due to selection of different alternatives in accounting procedures or practices. Financial reporting should

help users make comparisons among governments, for example, comparisons of the costs of specific functions or components of revenue.

LIMITATIONS OF FINANCIAL REPORTING

69. Governmental financial reporting objectives are affected not only by the characteristics of the governmental environment and the needs of users, but also by limitations of the information that financial reporting can provide. Users must understand these limitations to assess how financial reports can satisfy their needs.

70. Some information provided by financial reporting is based on approximate measures of past events. Some information may not be readily available from current-period accounting records and, therefore, may be costly to provide. In addition, information appearing in financial reports is often based on judgments or estimates arising from applying certain rules or conventions. Information that appears in financial reports is generally quantifiable, either in terms of dollars for financial information or by some other common denominator for nonfinancial data (miles of streets repaired, for example).

71. Financial reporting is only one source of information needed by users to make decisions about state and local governments. Governmental entities—and those who have an interest in them—are affected by numerous factors that interact with each other in complex ways. To make decisions, users need to combine the information provided by financial reporting with other pertinent information, for example, on general economic conditions or political environment.

72. Users of state and local governmental financial reports are diverse; their needs may be equally diverse. As a result, it may be impossible to provide information in any one report sufficient to meet all the needs of all users. Consequently, the type and amount of information provided in general purpose financial reports generally should be based on the common needs of users.

73. The Board recognizes that an accountability perspective in financial reporting complicates the cost-benefit analysis of information because accountability reporting may be virtually without limits. (See paragraph 57.) Cost encompasses the cost of preparing, auditing, and using information. The Board intends to maintain a broad perspective of the meaning and implications of accountability reporting. At the same time, it recognizes that information considered important by some users is not important to others. Excessive detail may confuse rather than clarify. Cost-benefit relationships will be carefully

considered by the Board, during its research and due process, when establishing individual standards. In assessing costs and benefits, the Board will consider such factors as the ability of certain classes of users to obtain information by special request, the intensity of the needs of all groups of users, the risks or costs to users of not having certain types of information, and the relative costs and benefits considering the size or type of governmental entities involved.

FINANCIAL REPORTING OBJECTIVES

74. The following objectives of state and local governmental financial reporting take into consideration the influence of the governmental environment on reporting both governmental-type and business-type activities, and the information needs of all users. The objectives apply to financial reporting by all governmental entities, including separate reporting by subunits of those entities.

75. The Board has concluded that there are no major differences in the financial reporting objectives of governmental-type and business-type activities. This is because business-type activities, whether performed through a separate legally constituted entity or through a department of government, are nevertheless a part of government and are publicly accountable. To the extent that there are differences in financial reporting objectives, they tend to be differences in emphasis caused by differences in the operating environment of each. In addition, the Board believes that many governmental activities cannot be easily categorized into either governmental-type or business-type. Users of financial reports may require different kinds of information depending on where on the overall spectrum of governmental- to business-type activities a particular activity falls. As a result, the Board believes the objectives presented in paragraphs 77–79 may apply in differing degrees to the two types of activities. For example, because of the differences in environmental factors, budgetary comparisons or information about funds flows may be less important to business-type activities, but cost of services information may be more important. However, both types of information are useful in differing degrees for all activities. The Board will recognize these different needs in developing specific standards to implement these objectives.

76. Governmental financial reporting should provide information to assist users in (a) assessing accountability and (b) making economic, social, and political decisions. The duty to be publicly accountable is more significant in governmental financial reporting than in business enterprise financial reporting. For this reason, the Board gave

considerable weight to the concept of accountability. It appears throughout the discussion of the governmental environment, and assessing accountability is a pervasive use of financial reporting as indicated in the section on uses of financial reports. Although it is referred to specifically only in paragraph 77, accountability is implicit in all of the listed objectives. The Board considers it to be the paramount objective from which all other objectives must flow.

77. *Financial reporting should assist in fulfilling government's duty to be publicly accountable and should enable users to assess that accountability.*

a. *Financial reporting should provide information to determine whether current-year revenues were sufficient to pay for current-year services.* This also implies that financial reporting should show whether current-year citizens received services but shifted part of the payment burden to future-year citizens; whether previously accumulated resources were used up in providing services to current-year citizens; or, conversely, whether current-year revenues were not only sufficient to pay for current-year services, but also increased accumulated resources.
b. *Financial reporting should demonstrate whether resources were obtained and used in accordance with the entity's legally adopted budget; it should also demonstrate compliance with other finance-related legal or contractual requirements.*[5]
c. *Financial reporting should provide information to assist users in assessing the service efforts, costs, and accomplishments of the governmental entity.* This information, when combined with information from other sources, helps users assess the economy, efficiency, and effectiveness of government and may help form a basis for voting or funding decisions. The information should be based on objective criteria to aid interperiod analysis within an entity and comparisons among similar entities. Information about physical resources (as discussed in paragraph 79b) should also assist in determining cost of services.

78. *Financial reporting should assist users in evaluating the operating results of the governmental entity for the year.*

a. *Financial reporting should provide information about sources and uses of financial resources.* Financial reporting should account for all outflows by function and purpose, all inflows by source and type, and the extent to which inflows met outflows. Financial reporting should identify material nonrecurring financial transactions.
b. *Financial reporting should provide information about how the governmental entity financed its activities and met its cash requirements.*

[5] For some items it may be sufficient to demonstrate compliance by identifying items or instances of noncompliance.

c. *Financial reporting should provide information necessary to determine whether the entity's financial position improved or deteriorated as a result of the year's operations.*

79. *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.*

a. *Financial reporting should provide information about the financial position and condition of a governmental entity.* Financial reporting should provide information about resources and obligations, both actual and contingent, current and noncurrent. The major financial resources of most governmental entities are derived from the ability to tax and issue debt. As a result, financial reporting should provide information about tax sources, tax limitations, tax burdens, and debt limitations.
b. *Financial reporting should provide 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.* This information should be presented to help users assess long- and short-term capital needs.
c. *Financial reporting should disclose legal or contractual restrictions on resources and risks of potential loss of resources.*

This Statement was adopted by the unanimous vote of the five members of the Governmental Accounting Standards Board:

James F. Antonio, *Chairman*
Martin Ives, *Vice-Chairman*
Philip L. Defliese
W. Gary Harmer
Elmer B. Staats

Appendix A

BACKGROUND INFORMATION

Demonstrating Accountability in Governmental Financial Reporting

80. The term *accountability* is used extensively in public administration literature but suffers from imprecise meaning. It is probably best understood in the context of stewardship, but it has been developed more recently within the context of performance auditing. Frederick C. Mosher, in *The GAO: The Quest for Accountability in American Government,* discusses both the need for accountability in government and the establishment of the U.S. General Accounting Office (GAO) to help achieve accountability on federal programs. On the nature of accountability, he writes:

> Even in simple times, accountability was hard to define and harder to assure. But there seem always to have been three essential elements. The first of these is *information:* information about the decisions and actions of those individuals and organizations who are held accountable to those others who are holding them to account. . . .
>
> A second requisite of accountability is that there be some individuals or organizations, outside *receivers and/or discoverers* of the information, who are able and willing to examine it, investigate it if necessary, digest it, and report it or initiate appropriate action based upon it. And the third has to do with recourse on the basis of such information (1) to correct deficiencies and improve performance and/or (2) to reward honorable and effective performance or penalize dishonesty, concealment, fraud, inefficiency, or ineffectiveness. . . [6]

E. Leslie Normanton, in a paper titled "Public Accountability and Audit: A Reconnaissance," wrote that "it [accountability] provides the post-mortem of action, the test of obedience and judgement, the moment of truth. . . ." He goes on to say that public accountability "is, actually or potentially, a rich and open source of knowledge about how government services function in actual practice, and hence of ideas about how they ought to function. It casts a spotlight upon institutions which are shy of the public's gaze, but whose qualities and imperfections have a steady cumulative impact upon our daily lives."[7]

---

[6] Westview Press, 1979, pp. 234 and 235.

[7] In Bruce L. R. Smith and D. C. Hague, *The Dilemma of Accountability in Modern Government* (St. Martin's Press, 1971), p. 312.

81. The concept of public accountability is manifested in many state laws and constitutions. For example, one state's constitution declares that government officials are substitutes or agents for the people and "are at all times accountable to them." The idea that "all power is inherent in the people" is written into many state constitutions. Unfortunately, a constitutional requirement alone does not assure accountability. Many state and local governments experienced spending and debt issuance abuses during the nineteenth and early twentieth centuries as those state and local governments grew in size and complexity. Public reaction to these abuses led to reforms in budgeting and accounting and financial reporting and in the ability to incur debt. Reformers believed that these reforms would provide a system of checks and balances that would demonstrate accountability to the extent possible with basic financial information. In describing this era of reform, Frederick A. Cleveland wrote, "This growing hostility to doing business in the dark, to 'boss rule,' to 'invisible government,' became the soil in which the 'budget idea' finally took root and grew."[8] The budgetary process, including comparison of the approved budget with actual experience, is therefore a major aspect of accountability.

Interperiod Equity

82. Public finance literature refers to the concept of intergenerational equity, both in a broad and a narrow sense. A broad view is expressed by Richard A. Musgrave and Peggy B. Musgrave, who state in their 1984 textbook, *Public Finance in Theory and Practice:*

> Those now living may affect the welfare of future generations in various ways. Thus advances in science and technology made by this generation will be at the disposal of the next. Similarly, the capital stock accumulated by the present generation is bequeathed as a legacy to the next one. In many ways the present generation thus benefits the future one. On the other hand, exploitation of irreplaceable natural resources and destruction of the environment place a burden upon the future. All these relationships—the asymmetrical fact that the present can affect the future but not vice-versa—pose questions of "intergenerational equity."[9]

83. Frances Oakey, in his 1921 work, *Principles of Government Accounting and Reporting,* discusses the concept in a more narrow sense:

---

[8]*The Annals* (November 1915), p. 22.
[9]McGraw-Hill, p. 99.

> The ease with which money may be borrowed on the public credit has often led governments into the error of meeting an undue proportion of expenditures out of the proceeds of the sales of bonds, with the result that a portion of the burden that should be borne by the present generation is continually shifted to later years. Under these conditions each generation is the recipient of a burden of debt which does not belong to it and which, nevertheless, must be carried in addition to meeting the needs of the current period. On account of the assumption of such a burden each generation is not inclined to, and in some cases cannot, meet the current needs of the year without the issuance of more bonds. The result is that the financial condition is very likely to become less favorable every year until a point is finally reached at which drastic steps must be taken to restore the financial condition to its former favorable state.[10]

84. The concept of intergenerational equity, or interperiod equity as the Board refers to it is reflected in the balanced budget requirements and debt issuance limitations of many state statutes and local ordinances. Virtually all states currently have balanced budget requirements of some type. Some states, for example, are bound by law to "raise revenue sufficient to defray the expenses of the state for each fiscal year." Some may even require a deficit in one year to be made up in the following year, a concept of budgetary balance over a multiyear period. The budgetary requirements of certain other states, and such practices as "off-budget" financing, however, may not result in true balanced budgets, in the sense that current-period revenues are sufficient to pay for current-period services. One state statute, for example, views debt proceeds as a revenue source and authorizes the governor to recommend ways to "balance" the budget "whether by an increase in the indebtedness of the state, by the imposition of new taxes, by increased rates on existing taxes or otherwise." The majority of local governments also have balanced budget requirements. Many of these requirements are set at the state level, but local governments may also have ordinances or administrative policies that require a balanced budget.

85. Some state laws on debt also address the issue of interperiod equity. For example, some require that debt may not be outstanding for a period longer than the useful life of the asset purchased with the proceeds. One state's law requires that "(a) the principal of each such bond shall be payable not later than 30 years after its date; and, (b) if such bonds shall be issued for the purpose of acquiring property or making improvements, then all the principal thereof shall be payable within the period of usefulness of the property or improvement." Another state's law declares that no debt may be contracted for a period

[10] Appleton, p. 214.

longer than that of the probable life of the work or purpose for which the debt is to be contracted.

86. The concepts of accountability and interperiod equity are related in the sense that interperiod equity is promoted by state and local laws requiring balanced budgets and debt limitations and restrictions; public officials are accountable for assuring compliance with those laws.

Other Implications of Accountability and Interperiod Equity

87. The notions of accountability and interperiod equity developed in this concepts Statement are readily adaptable to governmental budgetary and fiscal planning processes. For example, some suggest that one method of meeting objectives of accountability and interperiod equity would be to make budgetary estimates of the effects of new expenditure commitments resulting from such factors as new laws, program decisions, and major capital projects. They note that these commitments add significantly to taxpayer burdens in future years. This information could be disclosed through five-year revenue and expenditure projections issued after each legislative session and would be a logical extension of single-year budgeting requirements.

Appendix B

BASIS FOR CONCLUSIONS

88. This appendix discusses factors considered significant by Board members in reaching the conclusions in this concepts Statement. It includes discussions of the significant issues raised by respondents to the original Exposure Draft (ED), and its subsequent revision, and the Board's reasons for implementing some recommendations and rejecting others.

89. The Board issued its original ED, *Objectives of Financial Reporting*, on January 17, 1986 and held a public hearing on that ED on March 19, 1986. The Board received 58 written responses to the ED; 10 respondents also presented their views and answered Board members' questions at the public hearing. A revised ED was issued on October 30, 1986, incorporating the changes resulting from the Board's consideration of the responses to the original ED and the testimony given at the public hearing. The Board received 51 responses to the revised ED.

Scope of Statement

90. The scope of the document was an area of concern to many of the respondents to the original ED. The Board attempted to clarify the scope in the revised ED, but some respondents continued to express the belief that the ED's scope remained too broad in its application to all general purpose external financial reporting. These respondents were generally concerned that the Board may be establishing a goal that is too broad and that it will not be able to achieve. They were also concerned that the scope would lead the Board to extend the "basic GAAP" financial statements beyond the GPFS, and they cautioned the Board to consider the audit implications of standards that apply beyond the GPFS.

91. The Board considered the arguments made regarding the scope and continues to believe the scope as outlined in the revised ED and this Statement is appropriate. The Board has added language to clarify the issue in this Statement, emphasizing that developing and implementing standards to achieve these objectives will be an ongoing and evolutionary process. The Board has no preconception of precisely how an individual objective will be met. It is likely that some objectives will be accomplished in the GPFS without significant extension of the GPFS's scope. It is also likely that other objectives will be better accomplished by some means of reporting beyond the GPFS—in the CAFR, for example. In addition, some objectives may be met by standards developed for means

of reporting outside the CAFR—in condensed "popular" reports, for example. The Board will determine—on a standard-by-standard basis—the best means of financial reporting, and only after full due process. The Board believes that it is unlikely that all of the objectives will be, or can be, met through a single means of reporting, such as the GPFS. Similarly, the Board believes that what constitutes the minimum requirements for a GAAP presentation may not satisfy all of the objectives; consequently, some of the data developed to achieve certain objectives may not be required to be presented in the basic GAAP financial statements and may not be required to be audited.

Fixed Assets and Service Efforts Information

92. Many respondents to the EDs expressed doubt that cost-beneficial standards could be developed to satisfy some of the objectives. The objectives of providing information on (a) physical and other nonfinancial resources and their service potential and (b) service efforts, costs, and accomplishments appeared to be particularly troubling to those respondents. They argued that information necessary to satisfy these objectives would not be sufficiently useful or reliable to justify the expected high cost of developing and providing it. These respondents appeared to want explicit reassurance from the Board that cost-benefit considerations would play a significant role in the setting of individual standards. The Board is sensitive to the issue of cost/benefit; it is, and will continue to be, a significant consideration in developing individual standards. Accordingly, paragraph 73 was modified to better articulate the Board's belief.

93. The Board acknowledges that the methods used to evaluate the service potential of long-lived assets or to measure the accomplishments of a governmental entity are generally undeveloped. The Board also recognizes that developing and implementing standards to provide useful evaluations and measurements may take longer than other standards because of the time needed to establish information-gathering systems and gain experience by experimenting with alternative approaches. In May 1985, the Board formally encouraged preparers of governmental financial reports to experiment in reporting on infrastructure assets and service efforts and accomplishments. The Board does not underestimate the difficulties of developing cost-effective, objective standards to report that information. Nevertheless, the Board believes that for a government to fulfill its duty to be publicly accountable, information on service efforts, costs, and accomplishments and physical and other nonfinancial resources needs to be reported. Information about a government's service efforts and accomplishments, for example, would be useful to taxpayers and other resource providers in assessing the government's

performance and in making resource allocation decisions. This is because they (a) ordinarily cannot measure the government's performance in terms of profit or return on investment and (b) may not be familiar with the services provided because they are not direct recipients of them. In developing specific standards on service efforts, costs, and accomplishments and physical and other nonfinancial resources reporting, the Board will place significant emphasis on cost-benefit analyses.

General Cost-Benefit Considerations

94. In its Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* the FASB summarized its views on cost-benefit considerations in standards setting: "Before a decision is made to develop a standard, the Board needs to satisfy itself that the matter to be ruled on represents a significant problem and that a standard that is promulgated will not impose costs on the many for the benefit of a few. If the proposal passes that first test, a second test may subsequently be useful. There are usually alternative ways of handling an issue. Is one of them less costly and only slightly less effective? Even if absolute magnitudes cannot be attached to costs and benefits, a comparison between alternatives may yet be possible and useful." The GASB concurs with the spirit of the FASB's approach to cost-benefit considerations.

95. The Board believes that the concerns expressed by some respondents to the ED result primarily from the financial reporting implications of accountability. The Board recognizes that an accountability perspective results in establishing certain objectives for which standards-setting experience is limited—developing standards to implement those objectives is likely to occur over a relatively long time and may take forms not presently visualized. Nevertheless, the Board believes that an accountability perspective is essential to governmental financial reporting. The standards that result from this perspective will be issued only after appropriate due process.

FASB Concepts Statements

96. A few of the respondents to the EDs suggested that the Board needs to address a particular paragraph of FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations* (1980). In paragraph 3 of that Statement the FASB stated, "On the basis of its study to date, the Board is aware of no persuasive evidence that the objectives in this Statement are inappropriate for general purpose external financial reports of governmental units." These respondents are concerned that

there will be confusion among financial statement users, preparers, and auditors unless the GASB states that this concepts Statement on objectives of financial reporting supersedes or changes the applicability of FASB Concepts Statement 4 to governmental entities.

97. In response to this concern, the Board points out that the FASB made it clear in its Concepts Statement 4 that it did *not* reach a conclusion on the applicability of the Statement to governmental entities. They stated: "Nonetheless, the appropriate structure for setting financial accounting and reporting standards for state and local governmental units continues to be discussed. Pending resolution of that issue, the Board has deferred a final decision on whether the objectives set forth in this Statement should apply to general purpose external financial reporting by state and local governmental units."

98. The creation of the GASB in 1984 under the auspices of the Financial Accounting Foundation and the resulting structural and jurisdictional agreements for the standards-setting responsibilities of both the FASB and the GASB effectively resolved that issue. GASB Statement No. 1, *Authoritative Status of NCGA Pronouncements and AICPA Industry Audit Guide,* states: "Concerning the jurisdictional division between the GASB and the Financial Accounting Standards Board (FASB), the GASB structural agreement provides that the GASB will establish accounting and financial reporting standards for activities and transactions of state and local governmental entities and the FASB will establish such standards for activities and transactions of all other entities. Under this approach, pronouncements of the GASB rank above pronouncements of the FASB in the hierarchy of generally accepted accounting principles applicable to state and local governmental entities."

Appendix C

CODIFICATION INSTRUCTIONS

99. This Statement updates the November 1, 1984 *Codification of Governmental Accounting and Financial Reporting Standards* (Codification) by adding its contents (including Appendix A) to a newly created section, "Concepts," that precedes the "General Principles" section. In addition, the following changes should be made in the text of the Codification:

OBJECTIVES OF ACCOUNTING AND FINANCIAL REPORTING FOR GOVERNMENTAL UNITS **APPENDIX A**

[Add the following:]

.100 In May 1987, the GASB issued its Concepts Statement No. 1, *Objectives of Financial Reporting.* (See page xx.) That Statement supersedes the discussion in this appendix. Users of this Codification may still wish to refer to this appendix for objectives of governmental *accounting.* [GASBCS 1, ¶1]