

WHY GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING IS—AND SHOULD BE—DIFFERENT

EXECUTIVE SUMMARY

Governments are fundamentally different from for-profit business enterprises in several important ways. Their organizational purposes, processes of generating revenues, stakeholders, budgetary obligations, and propensity for longevity differ. These differences require separate accounting and financial reporting standards in order to provide information to meet the needs of stakeholders to assess government accountability and to make political, social, and economic decisions. Although state and local governments (herein after referred to as “governments”) in the United States have had separate standards for over 100 years, the question is sometimes asked: Why can’t general purpose governments (cities and counties, for example) simply apply the standards established for business enterprises?¹ The following questions and answers briefly address that issue, and the accompanying paper and its appendices provide an expanded discussion.

WHY ARE SEPARATE ACCOUNTING AND FINANCIAL REPORTING STANDARDS ESSENTIAL FOR GOVERNMENTS?

Separate accounting and financial reporting standards are essential because the needs of users of financial reports of governments and business enterprises differ. Due to their unique operating environment, governments have a responsibility to be accountable for the use of resources that differs significantly from that of business enterprises. Although businesses receive revenues from a voluntary exchange between a willing buyer and seller, most governments obtain resources primarily from the involuntary payment of taxes. Taxes paid by an individual taxpayer often bear little direct relationship to the services received by that taxpayer. Overall, taxpayers collectively

¹ The term *business enterprise* is used to refer to private-sector entities organized for the purpose of earning profit. Business enterprises in the United States apply accounting pronouncements of the Financial Accounting Standards Board. *Business enterprise* does not refer to and should not be confused with business-type activities of governments.

focus on assessing the value received from the resources they provide to a government. Governmental accounting and financial reporting standards aim to address this need for public accountability information by helping stakeholders assess how public resources were acquired and either used during the period or are expected to be used. Such reporting also helps users to assess whether current resources were sufficient to meet current service costs (or whether some costs were shifted to future taxpayers) and whether the government's ability to provide services improved or declined from the previous year.

The longevity of most governments and their role to maintain and enhance the well-being of citizens through the provision of public services also result in information demands that differ from those of business enterprises. For example, most governments do not operate in a competitive marketplace, face virtually no threat of liquidation, and do not have equity owners. Consequently, measures of net income and earnings per share have no meaning to users of governmental financial reports. Instead, users need information to assess the government's stewardship of public resources, including information to evaluate the manner and extent to which resources are devoted to specific services and the costs of providing those services. Users also need information to determine compliance with legally authorized spending authority. Creditors of both businesses and governments are interested in information on the ability to repay debt. However, government creditors focus more on information regarding the government's ongoing ability to generate resources and the costs of activities that could compete for those resources, rather than on information about how earnings are generated.

HOW DO EXISTING ACCOUNTING AND FINANCIAL REPORTING STANDARDS REFLECT THE DIFFERENT NEEDS OF STAKEHOLDERS?

The needs of the users of governmental financial reports are reflected in differences in the components of the conceptual framework for setting accounting and financial reporting standards and in specific accounting and financial reporting standards themselves. Although investors and creditors are important constituencies of every standards-setting organization, the Governmental Accounting Standards Board's (GASB) conceptual framework also places priority on addressing the informational needs of citizens and elected representatives, two constituencies not identified as users of business enterprise financial statements by the Financial Accounting Standards Board

(FASB). Consequently, the GASB's financial reporting objectives consider accountability to be the cornerstone on which all other financial reporting objectives should be built.

Some of the most significant examples of how GASB standards address differences between governmental and business financial reporting include (1) the view that capital assets are primarily used to provide services to citizens rather than to contribute to future cash flows; (2) the measurement and recognition of certain types of revenues (for example, taxes and grants); (3) the use of fund accounting and budgetary reporting to meet public accountability needs; (4) the use of accountability notions rather than equity control to define the financial reporting entity; and (5) the view that governments and their pension plans generally are ongoing entities with the ability to take a career-long view of the employment exchange. These and other accounting and reporting differences are described more fully beginning on page 12 and in Appendix B.

WHY IS THERE AN ONGOING NEED TO SET ADDITIONAL GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING STANDARDS?

Since its inception in 1984, the GASB has strived to meet the needs of the users of governmental financial reports by issuing standards that reflect their particular concerns and the unique features of the government environment. Although the GASB has established a substantial body of standards, the need to develop and improve accounting and financial reporting standards for governments still exists. For example, additional components of the conceptual framework, which enhances consistency in setting government standards, are still being addressed. In addition, governments and the governmental environment continue to evolve over time and new types of transactions or variations on existing transactions continue to arise, resulting in an ongoing need to update existing standards and to adopt new ones.

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WHY GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING IS—AND SHOULD BE—DIFFERENT

INTRODUCTION AND SCOPE

From time to time, the question is raised as to why state and local governments (herein after referred to as “governments”) cannot simply apply the same set of accounting and financial reporting standards that business enterprises² apply. This paper explains the need for separate standards for governments. It illustrates some of the differences between standards for governments and those for business enterprises and explains why standards setting for governments is an ongoing process.

In addition to providing more in-depth discussions in response to the questions posed in the Executive Summary, this paper also presents several appendices. Appendix A provides an expanded discussion of the environmental differences between governments and business enterprises. Appendix B provides additional examples of standards that illustrate the differences between governments and business enterprises and expands upon the discussion of examples in this paper. Appendix C provides historical perspective on the development of governmental accounting and financial reporting standards. Appendix D provides details on the significance of state and local governments in the United States. A brief glossary of governmental accounting terms is also included and begins on page 34. Terms defined in the glossary appear in **boldface type** when first used in this paper.

The scope of this paper is limited to comparing accounting and financial reporting standards for state and local governments to those required for business enterprises. It does not specifically address the standards set for organizations other than business enterprises, such as not-for-profit organizations, the Federal Government, or governments in other countries, and it does not suggest that standards for those organizations should not be set separately.

² See footnote 1 regarding the meaning of the term *business enterprises*.

Furthermore, governments in other countries may have different characteristics than governments in the United States; therefore, the paper does not address international differences.

WHY ARE SEPARATE ACCOUNTING AND FINANCIAL REPORTING STANDARDS ESSENTIAL FOR GOVERNMENTS?

Accounting and financial reporting requirements focus on the needs of the users of financial reports. Citizens, their elected representatives (such as legislatures and other oversight organizations), and creditors are the primary beneficiaries of the information in governmental financial reports. Financial reports of business enterprises generally are used by creditors and by equity investors and their regulators, but not by a type of stakeholder equivalent to citizens and their elected representatives.³ The needs of citizens and oversight organizations emphasize **accountability** for resources entrusted to the government, while the needs of equity investors emphasize information necessary to make rational investment, credit, and similar decisions. Accountability, in a general sense, is a responsibility of stewards or agents to provide relevant and reliable information relating to resources under their control. For governments, accountability is the government's responsibility to justify to its citizenry the raising of public resources and to account for the stewardship and use of those public resources. Accountability information can be used to support decision making, but it also fulfills the citizenry's "right to know" how public resources have been spent.

Creditors are a type of user of both governmental and business enterprise financial reports. Although they are generally looking for assurance that sufficient cash flows will be available to meet debt service requirements, certain information they seek from governments and from business enterprises is different because the source of debt repayment is different. Creditors and potential creditors of business enterprises seek information about how earnings are generated. Creditors and potential creditors of governments seek information about the ability and willingness of a government to levy taxes and generate other revenues to fund debt repayment and the costs and obligations of activities that could compete for those resources.

³ Elected representatives, such as legislators, are considered external users of financial reports because in many cases these individuals do not have access to the same internal financial data as do officials in the executive branch.

Although certain types of information in business enterprise financial reports could satisfy some needs of certain governmental financial report users, other users require different information. The accountability focus of governments and the broad range of sources of a government's resources lead to the conclusion that governmental financial report users ideally should be able to find additional information that will help answer questions such as the following:

- Did the government's ability to provide services improve or decline from the previous year?
- Were the government's current-year taxes and other sources of resources sufficient to cover the cost of current-year services? Was part of the burden of paying for current services shifted to taxpayers in future years?
- How did the government finance its activities and meet its cash requirements? Does the government have the capacity to meet future financial and service obligations?
- What are the government's spending priorities? What sources of resources support the various programs?
- Has the government obtained and used resources in accordance with its adopted budget and other legal requirements?
- What resources currently are available for future expenditures and to what extent are resources limited to specified uses?
- Has the government provided its services in an efficient and effective manner?

MAJOR ENVIRONMENTAL DIFFERENCES BETWEEN GOVERNMENT AND BUSINESSES

The differing needs of the users of governmental and business enterprise financial reports reflect the different environments in which the organizations operate. Some of the principal environmental differences are organizational purposes, sources of revenue, potential for longevity, relationship with stakeholders, and role of the budget. (An expanded discussion of the unique aspects of the government environment is included in Appendix A.)

ORGANIZATIONAL PURPOSES. The purpose of governments is to enhance or maintain the well-being of citizens by providing public services in accordance with public policy goals. Major public services provided by state and local governments include public safety, education,

social services, and transportation. Governments provide these services because the economic incentives are not sufficient for business to provide them at the quantity, quality, and price considered appropriate by public policy, among other reasons. Financial return on investment is not a goal for governments, so they need to develop and report other measures of accomplishment. The predominant business enterprise performance measures—net income and earnings per share—have little or no meaning in a governmental environment. Instead, governments focus on providing services and goods to constituents in an efficient, effective, and sustainable manner. A government's financial reports should give creditors, legislative and oversight officials, citizens, and other stakeholders the information necessary to make assessments and decisions relevant to their interests in the government's accomplishment of its objectives.

In contrast, business enterprises focus primarily on wealth creation, interacting only with those segments of society that fulfill their mission of generating a financial return on investment for shareholders. Historically, the primary focus of reporting has been on earnings and its components, with little explicit focus on nonfinancial measures of performance.

SOURCES OF REVENUE. The principal source of revenue for governments is taxation, which is a legally mandated involuntary **nonexchange transaction** between individual citizens and businesses and their government. The principal source of revenue of business enterprises is voluntary **exchange transactions** between willing buyers and sellers.

Because the levying of taxes is not a transaction in which equal values are exchanged at arm's length and is not part of an earnings process, as are most transactions of business enterprises, transactions involving taxes require specialized accounting treatment. For example, governments may levy or collect property taxes in a period prior to the period for which the taxes legally apply. The question then arises whether governments should record the taxes as revenue in the year levied or collected, or attribute them to the year for which the taxes apply. The GASB has addressed this issue by requiring that property taxes be reported as revenue *in the period for which* they are levied regardless of *when* they are levied. This promotes assessment of **interperiod equity** by associating revenues with the periods in which they finance the cost of services.

POTENTIAL FOR LONGEVITY. Because of their ongoing power to tax and because of the ongoing need for public services, governments rarely liquidate. The possibility of achieving longevity, however, is not as likely for business enterprises. Business enterprises will go out of existence if, for an extended period of time, they are unable to sell their products or services for more than it costs to produce them.⁴ Financial statements of business enterprises generally are prepared using a “going-concern” assumption, meaning that assets and liabilities are not adjusted to their liquidation values; however, this is not equivalent to a presumption of extended longevity. Users of business enterprise financial statements may use those statements to assess longevity. Financial statements of business enterprises emphasize the recoverability of assets, such as through future sales, and on the fair values of certain assets and liabilities. In contrast, the ability of governments to exist in the future generally is not in doubt (even in the extreme case of municipal bankruptcy), but rather the issues are the sustainability of the level of services provided and the ability to meet future levels of demand for services. As a result, governmental financial statements generally emphasize the allocation of resources to government programs, the determination of the cost of services, and providing a longer term view of operations.

The longer term view of operations of government is consistent with focusing on trends in operations, rather than on short-term fluctuations, such as in the fair values of certain assets and liabilities. Immediate recognition of changes in fair values of assets set aside in employee benefit plans is appropriate accountability reporting in the employee benefit plans that hold those assets and in the calculation of the employer’s net pension liability. However, it is not appropriate for government employers to recognize those fair value changes immediately in pension expense. These short-term fluctuations could produce a measurement of the period’s employee benefit costs, which would be included in cost of services that might be less decision-useful for governmental financial report users. The changes in fair value of these assets are required to be reported as either a deferred inflow of resources or a deferred outflow of resources and recognized in expense over a five-year period in order to mitigate the effects of short-term

⁴ For instance, according to the United States Census Bureau (<http://web.sba.gov/faqs/faqindex.cfm?areaID=24>), only a quarter of new employer firms last 15 years or more; by contrast, the number of general purpose governments remains remarkably steady—38,917 in 2012 versus 39,044 in 1997 (<http://www.census.gov/govs/>).

market changes on the reported costs of providing career-long benefits to government employees. Financial reporting by business enterprises is more likely to recognize such changes in fair value immediately because of the importance of the current value of equity.

RELATIONSHIP WITH STAKEHOLDERS. Individual citizens must pay taxes as agreed to by the citizenry collectively through elections or decisions of elected representatives, and as previously noted, individual taxes paid do not directly correlate with services received. Accordingly, governments should meet a benchmark of accountability that is broader than for business enterprises. Furthermore, citizens are interested in evaluating interperiod equity by determining whether current taxpayers and users of government services fully financed the costs of providing current-period services or whether taxes and user fees from prior or future periods were, or will be, needed to finance the current services provided. Consequently, one important focus of governmental financial reporting is on providing systematic and rational cost-of-service information. Additionally, users of governmental financial reports may wish to evaluate the combination of taxes, user fees, grants, and borrowings that financed current services. In contrast, because business enterprises focus primarily on increasing shareholders' equity, their financial reports show changes in equity of the enterprise during the current period. Except for those with large blocks of shares, public company shareholders typically can easily end their relationship with any individual business enterprise by selling their shares and, consequently, focusing on the current and future value per share. Lastly, as previously noted, creditors of governments and of business enterprises often look to different information.

ROLE OF THE BUDGET. For governments, a budget has special legal significance. Governmental budgets are expressions of public policy priorities and legally authorize the raising of public resources and the purposes for which public resources may be spent. In fact, governmental budgets can be the primary method by which citizens and their elected representatives hold the government's management financially accountable. For business enterprises, the budget represents an internal financial management tool that is controlled entirely by management and is considered proprietary in nature.

HOW DO EXISTING ACCOUNTING AND FINANCIAL REPORTING STANDARDS REFLECT THE DIFFERENT NEEDS OF STAKEHOLDERS?

The different needs of users of financial reports of governments and business enterprises are reflected both in differences in components of the **conceptual framework for accounting and financial reporting standards** and in the specific accounting and financial reporting standards set by the GASB and the FASB.

CONCEPTUAL FRAMEWORK DIFFERENCES

Both the GASB and the FASB have developed Concepts Statements setting forth the objectives of financial reporting. The objectives are the central core of the conceptual frameworks and reflect the differing needs of users of financial reports of governments and business enterprises.⁵ Reflecting the needs of their stakeholders, including citizens and their elected representatives, governments predominantly focus on accountability in financial reporting. For governments, information necessary to make political and social decisions is as important in shaping accounting and financial reporting objectives as information necessary to make economic decisions. Reflecting the needs of the stakeholders of business enterprises, including equity investors, financial reporting of business enterprises predominantly focuses on financial performance—earnings and its components. For business enterprises, information for making economic decisions is most important in shaping accounting and financial reporting objectives.

The GASB recognized in Concepts Statement No. 1, *Objectives of Financial Reporting*, that users of governmental financial reports also are interested in assessing nonfinancial performance of governments. The objectives, elements, and characteristics of service efforts and accomplishments (SEA) reporting were expanded on in GASB Concepts Statement No. 2, *Service Efforts and Accomplishments Reporting*, and subsequently amended in GASB Concepts

⁵ The conceptual framework of the GASB is not yet complete. As of March 2013, the GASB is developing additional Concepts Statements to identify recognition criteria for whether and when information should be reported in state and local governmental financial statements and considering the measurement issues that conceptually should be considered in setting standards for governments.

Statement No. 5, *Service Efforts and Accomplishments Reporting*. Further, the GASB issued Suggested Guidelines for Voluntary Reporting, *SEA Performance Information*, which provides a common framework for the effective external communication of SEA performance information. This framework establishes that the objective of an SEA report is to assist a government in meeting its responsibility to be accountable by providing users with information to assist them in assessing the government's performance in providing services. On the other hand, business enterprise financial reporting objectives typically do not recognize nonfinancial reporting measures. Some business enterprises may voluntarily report nonfinancial measurements in U.S. Securities and Exchange Commission filings or annual reports to shareholders, but that information is usually incidental to the financial information and not consistent between businesses. Although some believe that it would be beneficial to require business enterprises to report certain nonfinancial measures, competitive considerations of business enterprises may limit the amount and type of information that could be provided. Some nonfinancial measures that would provide decision-useful information to financial report users also might be considered "trade secrets" that would threaten the competitiveness of a business.

GASB Concepts Statement No. 4, *Elements of Financial Statements*, defines the elements of governmental financial statements. Although some definitions of elements have similarities to those in the FASB's Conceptual Framework, the GASB's definitions of the elements of financial statements reflect the unique characteristics of government. The GASB's definitions are interwoven with the provision of public service as the common thread. Central to most of the definitions is a *resource*, which in the government context is an item that can be drawn on to provide services to the citizenry. For example, one of the inherent characteristics of an asset is that it is a resource with present service capacity that the government presently controls. The present service capacity of a resource is its existing capability to enable the government to provide services, which in turn enables the government to fulfill its mission. Assets such as roads, schools, courthouses, libraries, and parks directly provide present service capacity in that the citizenry or public directly uses the asset. Other types of assets, such as investments, indirectly contribute to present service capacity because they can be held or sold to produce cash used to acquire public services and goods. For business enterprises, the future

benefit provided by an asset is its economic benefit—a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows.

GASB Concepts Statement 4 also identifies and defines deferred inflows of resources and deferred outflows of resources as elements of financial statements of governments. A deferred inflow of resources is an acquisition of net assets by a government that is applicable to a future reporting period that does not meet the definition of a liability. A deferred outflow of resources is a consumption of net assets by a government that is applicable to a future reporting period that does not meet the definition of an asset. In the government environment, deferred inflows of resources and deferred outflows of resources inherently have different characteristics from assets and liabilities. Further, GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, requires that these financial statement elements be reported separately from assets and liabilities. In contrast, business enterprises do not distinguish deferred inflows and outflows of resources from assets or liabilities.

ACCOUNTING AND FINANCIAL REPORTING STANDARDS DIFFERENCES

- ***CAPITAL ASSETS.*** Governments acquire most capital assets because of their capacity to provide services to the citizenry, whereas business enterprises acquire capital assets with the objective of using them to generate future cash flows. Consequently, GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, prescribes a method of assessing and measuring impairment of capital assets that reflects reductions in the service potential of capital assets as a result of impairing events or changes in circumstances. In contrast, business enterprises assess and measure impairment of capital assets by evaluating the future cash flows expected to be produced by the asset because the purpose of business enterprises is to create wealth.
- ***PROPERTY TAXES.*** Generating property tax revenue is a transaction unique to government. As previously noted, accounting and financial reporting standards for taxation should reflect reporting of property taxes as revenues in the same period as the cost of the services they were levied to pay for, in accordance with the need of users of governmental

financial statements to assess interperiod equity. For this revenue source, governments control all major events associated with potential points of recognition. Governments establish the assessment dates, the levy dates, the collection or due dates, and the periods for which the taxes are levied.

- **FUND ACCOUNTING.** Fiscal accountability for governmental activities is achieved by preparing financial statements using the **current financial resource flows measurement focus**—the long-standing measurement focus of **governmental funds**—and a **modified accrual basis of accounting**. This measurement focus emphasizes control and accountability over the raising and spending of public money. Financial reporting for governmental fund activities allows stakeholders to assess whether sufficient resources (generally cash and other liquid assets) existed to finance the current period’s activities. This assessment is particularly important to those who pay taxes and receive services. Fiscal accountability is demonstrated, for example, when governments prepare fund-based financial statements, which show whether resources were obtained and used in accordance with the legally adopted budget and in compliance with other finance-related legal or contractual requirements. GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, requires governments to report a balance sheet and a statement of revenues, expenditures, and changes in fund balances for their general fund, other major governmental funds, and nonmajor governmental funds in the aggregate. GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, establishes a fund balance reporting hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of resources reported in governmental funds. Governments also demonstrate accountability through reporting financial statements of fiduciary funds, which are used to report assets held for others in a trustee or agency capacity and therefore cannot be used to support the government’s own programs. These funds are not reported as part of the resources available to finance public services and goods but, rather, separately to demonstrate accountability for these resources.
- **PENSIONS.** Accounting and financial reporting standards for pensions for both governments and business enterprises are similar in that they are based on the notion that

these benefits are deferred compensation for employee services and should be accounted for in accrual-basis statements as the benefits are earned, rather than when paid. Beyond that, however, the measurement approaches adopted for use in the public and private sectors are different, as are many of the specific measurement and presentation choices, for reasons rooted in the different environments and the different information needs of stakeholders.

The longevity of governments, the importance of the cost-of-services information, and the desire of stakeholders to measure the degree to which interperiod equity has been achieved all influenced GASB Statements No. 67, *Financial Reporting for Pension Plans*, and No. 68, *Accounting and Financial Reporting for Pensions*. The measurement of a government's obligation for defined benefit pensions represents a career-long view of the employment exchange. Two differences with business enterprises that result from this career-long view are the rate used to discount future pension benefit payments to their present value and the method used to attribute pension liabilities to specific periods.

First, for governments, the selection of a discount rate for determining the actuarial present value of projected pension benefit payments depends on the amount of resources available in the pension plan for paying those benefits (from contributions and earnings related only to current active employees and retirees, not to future employees). As long as (1) the pension plan is projected to have these resources invested in a manner consistent with the long-term expected rate of return and (2) those resources are greater than or equal to the projected benefit payments for current employees and retirees, the discount rate is entirely based on the long-term expected rate of return on pension plan investments. However, if the projections show that a time will come when those conditions are no longer met (for instance, projected benefit payments are greater than projected plan resources), the discount rate should be based on a rate that reflects the effects of discounting benefit payments in that period and beyond using a municipal bond index rate or yield—for 20-year tax-exempt bonds rated AA or higher (or equivalent ratings). This approach reflects a change in the nature of the pension obligation for governments—from one expected to be satisfied, in part, through the accumulation of investment returns to one similar to a more typical government liability—when the plan assets are projected to not be sufficient to pay projected benefits.

Business enterprises are required to use a discount rate that reflects the rate at which pension benefits could be settled. In estimating that rate, FASB guidance allows businesses to look to available information about rates implicit in current prices of annuity contracts that could be used to settle the obligation or rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits.

Second, the effects of government employment exchange transactions on pension obligations is represented in a level manner as a percentage of projected pay over the entire projected career of the employee. In contrast, the accrual of a pension obligation for business enterprises reflects a pattern based primarily on the benefit formula as it relates to the assignment of benefits to each unit of service credit.

Additional differences in accounting and financial reporting standards that reflect differences in user needs are seen, for example, in (1) the financial reporting model, (2) the definition of the reporting entity, (3) service-oriented infrastructure assets, (4) grants and gifts, and (5) debt refundings. Additional information about these accounting differences is included in Appendix B.

WHY IS THERE AN ONGOING NEED TO SET ADDITIONAL GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING STANDARDS?

The environment in which governments operate fuels the need for new standards-setting projects. These governments are a significant component of the United States economy, generating 16.5 percent of gross domestic product, employing 11.7 percent of the nation's workforce, and incurring over \$2.9 trillion in debt⁶. As with other components of the economy, the activities and transactions of governments continue to change and often increase in complexity. For example, some governments have issued bonds secured with proceeds from a master settlement agreement with the major tobacco companies. These transactions often

⁶ According to the data available in Table L.211 on <http://www.federalreserve.gov/Releases/Z1/Current/z1.pdf> viewed on February 26, 2013.

involved new and complex legal structures. The GASB issued Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issues*, to address accounting for these transactions. As governments have expanded their activities in selling and pledging other types of receivables and future revenues, the GASB determined that additional and broader standards were necessary and issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. Finally, as governments have increasingly entered into service concession arrangements (a type of public-private partnership), the GASB determined that additional guidance was necessary to enhance the consistency and comparability in reporting these types of arrangements and issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. Given the emergence of new government transactions, increasing complexity of existing government transactions, financial innovations, and changes within the governmental environment, such as with growing interdependencies among different levels of government, new standards-setting projects likely will continue to arise.

CONCLUSION

Governments are fundamentally different from business enterprises. As a result, separate accounting and financial reporting standards for governments are essential to meet the specific needs of the users of governmental financial reports. The standards for governments need to reflect their unique environment, including different organizational purposes and special legal powers, and to effectively address public accountability issues inherent to governments.

APPENDIX A

DISTINGUISHING CHARACTERISTICS OF THE GOVERNMENTAL ENVIRONMENT

ORGANIZATIONAL PURPOSES

As stated in GASB Concepts Statement 2 (paragraph 48), the principal purpose of governments is to provide services that enhance or maintain the well-being of their citizens. Government services, such as establishing and maintaining the legal system, and providing public safety, education, social services, and transportation services, are necessary for enhancing or maintaining the well-being of citizens. However, those services generally would not be provided by the private sector at the quantity, quality, and price considered appropriate by public policy. The private sector, which focuses primarily on generating a financial return on investment, could not make a profit by providing most of these services, in an equitable manner, to the citizenry. The purpose of government is not to generate a financial return on investment but, rather, to provide public services and goods as determined through the political process in an effective and efficient manner. As discussed below, even when governments provide the same type of services as a business enterprise, such as hospital services, the government does not do so with the intention of earning a profit.

Other circumstances that governments are expected to address are when the cost of a service or good is not exclusively borne by the producer or recipient of the service or when the benefit of a service or good is not exclusively enjoyed by the purchaser or recipient of the service or good. For example, emission of pollutants is a cost that often is borne by society as a whole rather than the individual or business generating the pollutants. Business enterprises that create pollution may appear to be more efficient and may be more competitive because certain costs are passed on to citizens. An example of a service with a benefit that is not exclusively enjoyed by the purchaser or recipient of the service is vaccination against communicable disease. Vaccination benefits not only the individual vaccinated but also any individuals who might

otherwise have contracted the disease through contact with the vaccinated individual. The role of government regarding such circumstances may be to provide the service or good or to regulate it.

The prevalence of public services and goods in government, and of viewing the benefits and costs of those services and goods from a societal perspective, results in a somewhat different approach to measurement in governmental financial reports.

SOURCES OF REVENUE

Governments often receive substantial revenues from nonexchange transactions (for example, taxes and grants), also referred to as nonreciprocal transactions in some accounting literature. Nonexchange transactions are different from exchange transactions, such as sales revenue and debt or equity financing. In a nonexchange transaction, a government either receives value from another party without directly giving equal value in exchange or gives value to another without receiving equal value in exchange.

Taxpayers are involuntary resource providers; they cannot legally choose whether to pay taxes, even if they do not receive or take advantage of all services provided. The amount of taxes paid by an individual generally depends on factors such as the value of property owned or income earned and seldom bears a direct relationship to the cost or value of the services received by that individual from the government.

Both business enterprises and governments borrow funds to finance their operations and capital improvements. Creditors, whether of governments or of business enterprises, have a similar focus in using financial reports—evaluating the cash flows of an organization to assess the ability of the organization to meet its obligations on a timely basis. However, how those cash flows are generated is quite different. GASB Concepts Statement 1 describes the needs of creditors in paragraph 35:

Investors and creditors^[7] need information about available and likely future financial resources, actual and contingent liabilities, and the overall debt position

^[7] Note that the GASB defined *investors and creditors* in paragraph 30 to be those who lend or who participate in the lending process. *Investors* is not used to mean equity owners.]

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

Government operations are not financed through equity ownership. Ownership interests in business enterprises may be bought and sold, but this is not so in government. Therefore, governments have no compelling reason to frame or orient financial statements in a way that is primarily focused on facilitating decisions of an equity market or of equity investors, which typically use financial reporting to assess the value of their ownership interest and whether that value is increasing or decreasing.

POTENTIAL FOR LONGEVITY

Governments typically have greater longevity than business enterprises. For example, some governments trace their origins to the original thirteen colonies. As a result of a combination of factors, including the power to tax, the nature of and need for the services provided, and a lack of market competition, governments rarely liquidate. From time to time, governments may combine through a merger or acquisition, but basic services will continue to be provided. Provisions for municipal bankruptcy are found in Chapter 9 of the federal bankruptcy code, which provides for reorganization of municipalities, but not for their liquidation. Additionally, the provisions of Chapter 9 can be invoked only at the discretion of qualifying municipalities, not by creditors. Historically, the number of municipal bankruptcy filings has been approximately 0.001 percent of the number of business bankruptcy filings.⁸ Because governments often have the power to tax—a right in perpetuity to impose charges on persons or property—they have the ability to continue operating in perpetuity. In contrast, business enterprises are at risk of going out of business because they are dependent upon market-determined demand for their goods and services to generate revenues. If they cannot produce

⁸ According to data available on <http://www.uscourts.gov/bkprctystats/bankruptcystats.htm>, viewed on January 11, 2013, 204 local governments filed under chapter 9 during the period 1990 through 2011, whereas 19,703,365 businesses filed under either chapter 7 or 11 during the same period.

products or services efficiently and at a cost less than the price the market will pay for the product or service, they will lose money and eventually leave that market or go out of business. They also may go out of existence if they are acquired by another entity. The relative longevity of governments is reflected in the long-term view applied in governmental financial reporting.

RELATIONSHIP WITH STAKEHOLDERS

Governments in the United States employ the principles of representative democracy. The power of citizens to participate in most decision making regarding the operations of their government is delegated to public officials through the election process. Accompanying this delegation of power 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. Governments can be viewed as being “owned” by the public similar to how business enterprises are owned by their shareholders. However, the public’s “ownership” is on an involuntary basis through paying taxes and receiving certain services from their government as determined collectively through elections or decisions of elected representatives. Shareholders voluntarily choose to invest in a business enterprise and do not demand services from the business enterprise; rather, they demand a financial return on their investment. Shareholders typically can easily end their relationship with any individual business enterprise by selling their shares. In contrast, citizens typically can end their relationship with any particular government only by moving to another jurisdiction.

Although the shareholders of a business enterprise place high importance on and are concerned with the value of their ownership interest, the public as owners of a government do not share that same concern. Because revenues raised through governments’ power to tax are expected to be used to advance the public interest, the public is entitled to hold governments to a degree of accountability that is broader than for business enterprises. The notion of accountability permeates the GASB’s conceptual framework and its individual standards. GASB Concepts Statement 1 states that accountability is the cornerstone of all financial reporting in a representative democracy and that government must answer to its citizens to justify its raising of public resources and the purposes for which the resources are used (paragraph 56). GASB Concepts Statement 1, paragraph 56, further states:

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.

The concept of interperiod equity is inextricably linked with accountability in government. Interperiod equity measures whether current-year revenues were sufficient to pay for the services provided that year, thereby avoiding shifting a burden to future taxpayers for services previously provided. GASB Concepts Statement 2, paragraph 20, provides insight into the breadth and complexity of the concept of accountability by describing several aspects of accountability:

Governmental accountability can be viewed from several perspectives. For example, from an accounting perspective, in 1970 the American Accounting Association's (AAA) Committee on Concepts of Accounting Applicable to the Public Sector divided what entities are accountable for into four parts:

- a. Financial resources.
- b. Faithful compliance or adherence to legal requirements and administrative policies.
- c. Efficiency and economy in operations.
- d. The results of government programs and activities, as reflected in accomplishments, benefits, and effectiveness.

Demonstrating accountability necessarily takes many forms. For example, financial reporting should provide information regarding government’s stewardship responsibilities, in addition to information about interperiod equity. Stewardship responsibilities are reflected in fund reporting and in budgetary reporting, which are addressed subsequently. A budget does not demonstrate interperiod equity in that, for example, it is possible to have a balanced budget that meets legal requirements, yet employs deficit financing or deferred maintenance, which would not promote interperiod equity. However, the budget serves the crucial role of documenting short-term financial plans. Furthermore, additional types of reporting to assess the performance of government programs and activities also are needed.

Accounting and financial reporting standards for business enterprises do not emphasize accountability to the same extent.⁹ Reflective of the commercial environment, the FASB has determined that financial reporting for business enterprises primarily has an investor and creditor focus, as indicated in FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, Chapter 1, “*The Objective of General Purpose Financial Reporting*”:

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit. [paragraph 2]

ROLE OF THE BUDGET

Instead of market forces, which exert a level of control over the operations in business enterprises, the budget is the principal source of control over operations in government. The budget generally is a legal document that authorizes the government to utilize its resources to conduct operations, pay financial obligations, and provide services. In contrast with budgets of business enterprises, which are internal, proprietary documents, budgets of governments are public documents that express public policy priorities and financial intent. In the U.S. system of government, based on checks and balances among the three branches of government, the budget is uniquely important because it is the practical means used by the legislative branch to set limits on the power of the executive branch. The citizenry often has an opportunity to provide input into the formation of the budget by commenting on an openly publicized proposed budget or, in some jurisdictions, voting on a proposed budget. Citizens and their elected representatives have the right to know whether the government actually used funds and resources in accordance with

⁹ Undeniably, the Sarbanes-Oxley Act has increased the requirements of public business enterprises to focus on stewardship and to be more accountable, in a general sense, to their shareholders. For example, officers of public business enterprises are required to make certifications with respect to their business enterprise’s financial reports prepared in conformity with Generally Accepted Accounting Principles (GAAP) and their internal control structure, and may suffer substantial penalties for noncompliance. This provides an important incentive for adherence to existing GAAP but does not impose additional financial reporting requirements.

the approved budget. Demonstrating accountability for compliance with budget authority is a distinguishing objective of governmental financial reporting.

APPENDIX B

ADDITIONAL EXAMPLES OF HOW GOVERNMENTAL ACCOUNTING DIFFERS FROM BUSINESS ENTERPRISE ACCOUNTING

The unique characteristics of government affect the substance and form of information communicated through external governmental financial reports. The driving force for governmental financial reporting is accountability—accountability to citizens and taxpayers, legislative and oversight bodies, and holders or potential holders of government debt. Each of these stakeholders seeks information that he or she expects to derive from a government’s financial report. For example, when deciding where to live and how to vote, citizens may wish to compare their local government with other governments to assess the range of services provided and the cost of those services. Business owners may wish to compare the costs imposed by local governments and the services provided in competing jurisdictions when assessing where to locate a new business or relocate an existing business because it may affect their overall cost of conducting business. Legislative and governmental oversight bodies may wish to gain insight into how efficiently a government is using its resources and whether a government is complying with budgetary and contractual provisions. Holders or potential holders of governmental debt may wish to determine whether a government is able to repay its debt in both the short and the long term. Governmental financial reports provide all this information and more.

The following discussion reviews selected governmental accounting and financial reporting standards, highlights how standards address some of the distinguishing characteristics of government, and identifies how the information provided in the standards benefits users of governmental financial reports. Appendix C includes a brief history of governmental accounting and financial reporting standards setting, which highlights the evolution of governmental accounting and financial reporting.

THE FINANCIAL REPORTING MODEL. The financial reporting model for governments has many unique features, including:

Contents of Basic Financial Statements. A government's basic financial statements present information about fiscal and **operational accountability**. The financial statements of governments present operational accountability information in the form of statements of financial position, changes in financial position, and cash flows. In addition, fiscal accountability is demonstrated by governmental fund financial statements, as described in the main body of this paper.

Operational accountability goes beyond fiscal accountability by examining management decisions from a long-term perspective rather than the short-term focus inherent to fiscal accountability. Instead of focusing on whether sufficient resources exist to *pay* for services provided during a period, operational accountability considers whether sufficient resources exist to cover the *cost* of providing services in the long term, and it is measured using the **economic resource flows measurement focus**. Operational accountability is demonstrated when governments issue accrual-based financial statements for the entire government. GASB Statement 34 requires reporting on operational accountability for all activities, including governmental activities, in consolidated government-wide statements.

Statement of Net Position. The statement of net position reports a government's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position, which is the residual of assets and deferred outflows of resources and liabilities and deferred inflows of resources. In contrast, a business enterprise's balance sheet reports assets, liabilities, and equity or partners' capital, which is the residual interest in the assets of an entity that remains after deducting its liabilities. Deferred inflows of resources and deferred outflows of resources relate to a future reporting period and are therefore not yet recognizable as revenues or expenses; however, they do not meet the definitions of, and therefore cannot be recognized as, assets and liabilities. GASB Statements No. 53, *Accounting and Financial Reporting for Derivative Instruments*, No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, No. 65, *Items Previously Reported as Assets and Liabilities*, No. 68, and No. 69, *Government Combinations and Disposals of Government Operations*, specifically provide guidance

for the recognition and measurement of deferred inflows of resources and deferred outflows of resources.

Statement of Activities. Unlike an income statement of a business enterprise, the statement of activities focuses on the cost of services provided by function or program and the extent to which they either contribute to or draw from the general revenues of the government. The statement serves as the basis for beginning an analysis of management's performance, but for a more complete assessment of effectiveness and efficiency, additional performance measures would need to be considered.

Budgetary Reporting. GASB standards require governments to report budgetary comparisons, either as required supplementary information or as a basic financial statement. The involuntary nature of tax collection creates a responsibility on the part of the government to be accountable to stakeholders for the use of those taxes. The budget is the mechanism for documenting public policy choices and authorizing the allocation and use of these resources. Unlike business enterprises for which budgets are an internal planning tool, evidence of compliance with the legally adopted budget is necessary for publicly demonstrating accountability. GASB Statement 34 requires that governments present budgetary comparison schedules, including both the original and the revised budget, in the interest of accountability to those who are aware of, and perhaps made decisions based on, the original budget.

REPORTING ENTITY ISSUES. A fundamental decision regarding financial reporting is determining which entities should be presented together in the same financial report. Consolidations of business enterprises are generally based upon control obtained through acquisition of equity interests, a form of ownership and the financial benefits and burdens that accompany that ownership interest. The standard for determining the reporting entity for governments reflects a difference of the governmental environment—the lack of equity ownership. Consequently, control through equity ownership is not the starting point for the governmental reporting entity standard. Governmental combinations principally are based upon control over other governments through complex relationships of accountability, which is a broader concept than that of business enterprises. Therefore, the GASB issued Statement No. 14,

The Financial Reporting Entity, subsequently amended by Statements No. 39, *Determining Whether Certain Organizations Are Component Units*, and No. 61, *The Financial Reporting Entity: Omnibus*, addressing these issues based upon the notion of accountability, which is described in paragraph 56 of GASB Concepts Statement 1 as the “cornerstone of all financial reporting in government.”

SERVICE-ORIENTED INFRASTRUCTURE ASSETS. Governments provide some services through acquisition and maintenance of **infrastructure**, such as roads, bridges, and water systems. The accounting methods used for these assets reflect the long-lived nature of these assets and the perpetual existence of government. Although the GASB and the FASB apply the same basic historical cost/depreciation approach to reporting most capital assets being depreciated, the GASB allows an optional **modified approach** for accounting for infrastructure that recognizes a government’s long-term commitment to provide service through maintenance and preservation of infrastructure at a specified condition level. The modified approach allows a government to recognize the amounts expended to maintain infrastructure assets in a specified condition as expense for cost of services instead of depreciating them. The disclosures associated with the use of the modified approach provide forward-looking data, including indicators of potential future demands on resources and information about deferred maintenance.

GRANTS AND GIFTS. As noted earlier, business enterprises only infrequently engage in nonexchange transactions, such as grants and gifts, (except as payer), and when they do so, the amounts involved generally are relatively insignificant to the business. However, for many governments, grants and gifts are a significant source of revenue, and GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, provides guidance in this area. For grants and gifts, characteristics such as time restrictions and eligibility requirements are critical to determining when a transaction should be recognized.

Governments often receive pass-through grants—grants and other financial assistance to transfer to or spend on behalf of a secondary recipient. GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, requires reporting all cash pass-through grants in a government’s financial statements. They are recognized as revenues and expenditures or expenses unless the government acts strictly as a cash conduit.

(That is, the government only transmits the grantor-supplied money without having administrative or direct financial involvement.) This reporting requires governments to demonstrate accountability for resources for which the government is responsible. In contrast, business entities apply the guidance in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, which excludes reporting certain pass-through grants as revenues and expenses.

DEBT REFUNDINGS. Similar to pensions, both governments and business enterprises engage in refundings of debt—that is, the issuance of new debt whose proceeds are used to repay previously issued (“old”) debt. The reason that both governments and business enterprises typically enter into refundings is to secure financial gains. In most refundings, a difference exists between the reacquisition price for the old debt and the net carrying amount of the old debt. These differences either are accounted for as accounting gains or losses immediately in the period of extinguishment or can be deferred and recognized as adjustments to interest expense over the shorter of the life of the old or new debt. When determining how these differences should be accounted for in a governmental environment, the decision was made that the differences should be deferred and recognized as adjustments to interest expense. Deferred recognition is consistent with the fact that government refundings generally are current or advance refundings, and rarely or never are funded through existing resources or equity issuance. This accounting also is consistent with the concept that the economic gain from the refunding generally is used to reduce the interest costs of future taxpayers and, consequently, should be reported as an adjustment to future interest expense. This was different from the then-applicable business enterprise accounting and financial reporting standards because it was believed that immediate recognition would produce operating results in the period the debt is refunded and in subsequent periods that were less decision-useful for users of governmental financial reports. The GASB was concerned then, as it was later when developing GASB Statement 34, that governmental financial reports present the most relevant measure of the cost of providing services for a period.

APPENDIX C

BRIEF HISTORY OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING STANDARDS SETTING

Systematic governmental financial reporting in the United States traces its beginnings to the last decade of the nineteenth century and early part of the twentieth century. At that time, the growth in the number and size of cities, coupled with corruption in municipalities, led to a demand for financial accountability.¹⁰ Many of the features of modern-day governmental financial reporting can be seen in the *Handbook of Municipal Accounting* (1913) prepared by the Metz Fund and in the writings of Francis Oakey (whose book *Principles of Government Accounting and Reporting* [1921] was considered authoritative) and Lloyd Morey (whose popular textbook, *Introduction to Governmental Accounting*, was published in 1927). Oakey and Morey were concerned that the then “commercial accounting” was not entirely adequate for governments.

Morey identified the lack of a profit motive as one important factor that would affect financial reporting for governments; there was no need for governments to report on profit and loss. Oakey stated that cities financed their operations through taxes, miscellaneous revenue, and borrowing for the purpose of raising sufficient amounts to meet total anticipated expenditures, including capital items. He believed financial reporting should show a government’s fund surplus (or balance) that represents the resources currently available for expenditure. Oakey and Morey advocated financial reporting using funds, which would allow readers to assess whether an executive officer of a city had properly discharged his or her duties in accordance with legal requirements. The writings of Oakey and Morey contributed to the formation of the National Committee on Municipal Accounting (NCMA), which began to promulgate standards in 1934.¹¹

¹⁰ Frederick A. Cleveland, *Chapters on Municipal Administration and Accounting* (New York: Longmans, Green and Co., 1909).

¹¹ James H. Potts, “An Analysis of the Evolution of Municipal Accounting to 1935 with Primary Emphasis on the Developments in the United States” (Ph.D. dissertation, University of Alabama, 1976). Marcel G. Hebert, “An

To ensure that governmental accounting issues received appropriate attention, the NCMA was formed as an ad-hoc committee of the Municipal Finance Officers Association (MFOA). It and successor bodies formed under the MFOA formulated municipal accounting principles, developed common classification and terminology for municipal reports, and promulgated standards that reflect the unique or distinguishing characteristics of government. The NCMA believed that reporting budgetary information compared to actual information in financial statements was important to demonstrate compliance with legal provisions and to show proper administration of finances. Therefore, they recommended that governments present statements that would compare estimated revenues with actual revenues, and appropriations with expenditures and encumbrances.

Through the efforts of the NCMA and the National Committee on Governmental Accounting (NCGA), a successor committee of the MFOA, including publication of the authoritative guidance in the 1968 “blue book” titled *Governmental Accounting, Auditing, and Financial Reporting*, governmental financial reporting evolved from reporting on individual funds to reporting combined and combining financial statements for governmental, proprietary, and fiduciary funds. Concomitant with changing the name of the NCGA to the National Council on Governmental Accounting, the NCGA was reorganized as a standards-setting body that followed due process procedures and continued to focus governmental fund financial reporting on the flow of current financial resources using the modified accrual basis of accounting.

Subsequently, critics of governmental financial reporting called for governments to report more like businesses. Criticisms were leveled at the differences between financial reporting by business enterprises and governments, citing lack of understandability because government financial statements used the modified accrual basis of accounting and reported a number of funds without consolidation. The recommendation was not that governments and business enterprises should report using the same set of accounting and financial reporting standards or that a single standards setter should be responsible for both types of organizations. Rather, the

Investigation of the Effect of Alternative Presentation Formats on Preparers and Users of City Financial Reports” (Ph.D. dissertation, Texas Tech University, 1987).

recommendation primarily was to bring the benefits of accrual accounting—full cost of services information and consolidated financial statements—to governments. Through issuance of many standards including GASB Statement 34, the GASB has addressed these criticisms while not ignoring the distinctive characteristics of government that are a key part of its reporting objectives.

The Financial Accounting Foundation established the Governmental Accounting Standards Board in 1984 as the independent standards setter for state and local governments. The decision to establish a separate standards board reflects the sovereign nature of state governments and their desire to have a standards setter that focused on the needs of the state and local government financial statement users. State governments are not creations of the federal government. Rather, the federal government was created by the states upon ratification of the United States Constitution, with certain aspects of states' sovereign powers transferred to the federal government, and with all other powers retained by states. Establishment of accounting and financial reporting standards for themselves (and local governments, which were created by states) is a power retained by the states. Like Oahey, Morey, the NCMA, and the NCGA, the GASB recognizes the unique and distinguishing features of government and reflects them in its standards setting.

APPENDIX D

SIGNIFICANCE OF STATE AND LOCAL GOVERNMENTS

By any measure of size, state and local governments are a substantial part of the U.S. economy. According to the 2012 Census of Governments, there are 89,004 local governments in the United States. Because the entire 2012 Census of Governments was not completed at the time this white paper was issued by the Board, the Census data that follows was identified through other Census reports prepared annually. According to the Census Annual Survey of State and Local Government Finance, revenue collected by state and local governments in 2010 totaled \$2.1 trillion—\$6,803 for every person in the United States. Expenditures, taking into account capital outlays often financed through borrowings (which are not reported as revenues in these statistics), of state and local governments in 2010 are even larger, at \$2.4 trillion—\$7,775 per capita. For comparison purposes, these state and local government expenditures represent almost 16.5 percent of the 2010 U.S. gross domestic product of \$14.4 trillion as reported by the Bureau of Economic Analysis of the U.S. Department of Commerce. Debt outstanding owed by state and local governments in the third quarter of 2012 totaled over \$2.9 trillion according to the Federal Reserve Board’s Flow of Funds referenced previously—\$8,400 per capita. The 2010 Census Annual Survey of Public Employment and Payroll reports that the labor force of state and local governments totaled 16.8 million employees on a full-time-equivalent basis, or 11.7 percent of total employment of the 143.3 million workers in the United States as reported by the Bureau of Labor Statistics of the U.S. Department of Labor for 2010.

Not only do state and local governments constitute a significant proportion of the U.S. economy, they also have a pervasive effect on society because they provide a broad variety of vital services, including education, public safety, transportation, social services, environmental services, housing, utility services, and administrative services. Education includes primary, secondary, and higher education. Public safety includes police and fire protection, correctional facilities, and regulation and licensing of businesses. Transportation includes highways, airports, ports, parking facilities, and transit systems. Social services include income maintenance and healthcare. Environmental services include protection of natural resources and park and

recreation services. Utilities include electric power, gas, water, sewer, and solid waste disposal. Administrative services include judicial and legal services, financial administration, and governance.

APPENDIX E

GLOSSARY

Accountability—A government’s responsibility to justify to its citizenry the raising of public resources and the purposes for which the resources are used.

Conceptual framework for accounting and financial reporting standards—A high-level set of concepts that guide a standards setter when deliberating future standards and evaluating existing standards and practices.

Current financial resource flows measurement focus—The focus of governmental fund financial statements, which is on inflows of financial resources that are available for use to pay current obligations and on outflows of financial resources that generally arise when liabilities become due and are normally expected to be paid using available financial resources.

Economic resource flows measurement focus—The focus of government-wide and proprietary fund financial statements, which is on inflows and outflows of economic resources.

Exchange transaction—A transaction in which each party receives and gives up essentially equal values.

Fiscal accountability—The responsibility of governments to justify that their actions in the current period have complied with public policy decisions concerning the raising and spending of public moneys in the short term (usually one budgetary cycle or one year).

Governmental activities—Activities of government that generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues. These activities are usually reported in governmental funds and internal service funds. In contrast, business-type activities of governments are financed in whole or in part by fees charged to external parties for goods or services.

Governmental funds—Self-balancing sets of accounts that are maintained for governmental activities. Governmental fund types include the general fund, special revenue funds, capital project funds, debt service funds, and permanent funds. Financial statements of governmental funds focus primarily on the sources, uses, and balances of current financial resources and often have a budgetary orientation.

Infrastructure—Long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets.

Interperiod equity—The extent to which the current-year revenues are sufficient to pay for the services provided that year and whether future taxpayers will be required to assume burdens for services previously provided.

Modified approach—A method of accounting for certain infrastructure assets that are part of a network or subsystem of a network in which depreciation expense is not reported and maintenance and preservation costs are expensed. A network or subsystem qualifies for this method of accounting when, among other conditions, management has committed to maintain the network or subsystem approximately at or above a specific condition level.

Modified accrual basis of accounting—The basis of accounting in which transactions are recognized when they occur with specifically identified modifications to reflect the current financial resource flows measurement focus. These modifications include the fact that expenditures are recognized in the period in which they are expected to require to use current financial resources, revenue is not recognized until it is available to pay current obligations, and certain long-term liabilities are not recognized until due and payable.

Nonexchange transaction—A transaction in which a government gives (or receives) value without directly receiving (or giving) equal value in return. This is also referred to as a nonreciprocal transaction in some accounting literature.

Operational accountability—The responsibility of governments to report the extent to which they have met their operating objectives efficiently and effectively, using all resources available

for that purpose, and whether they can continue to meet their objectives for the foreseeable future.