

## **FACT SHEET: FINANCIAL REPORTING MODEL IMPROVEMENTS**

### **1. What is the financial reporting model?**

The *financial reporting model* is the blueprint for a government's audited annual financial report. It is the part of generally accepted accounting principles (GAAP) that describes the layout and contents of the report—a government's financial statements, notes to financial statements, and required supplementary information (RSI).

### **2. What has the GASB proposed regarding the financial reporting model?**

In June 2020, the GASB issued an Exposure Draft, [\*Financial Reporting Model Improvements\*](#) for public comment. The Exposure Draft is the third document for which the GASB has sought public input in an effort that began in 2013 with research evaluating the effectiveness of the existing standards. The proposed improvements in the Exposure Draft reflect what the GASB heard from hundreds of preparers, auditors, and users of financial statements in response to the first two documents. The GASB recognizes that stakeholders have expressed a wide variety of views on those issues.

### **3. What has the GASB proposed to improve the governmental fund financial statements?**

The [\*Exposure Draft\*](#) proposes a *short-term financial resources* measurement focus and an *accrual* basis of accounting for governmental fund financial statements. The proposal is, in many ways, similar to what is required now, but it resolves many of the problems that undermine the usefulness of governmental fund information.

Under the proposal, the guidance for which assets, liabilities, inflows, and outflows to report in the governmental funds and when to report them would depend on whether they result from short-term transactions and events or long-term transactions and events. Assets, liabilities, inflows, and outflows resulting from short-term transactions and events should be reported when the transaction or event occurs. Assets, liabilities, inflows, and outflows resulting from long-term transactions and events should be reported when payment is due.

### **4. Why didn't the GASB propose using the same economic resources measurement focus as the government-wide financial statements?**

The GASB did not propose a wholesale overhaul of the existing measurement focus and basis of accounting because it is evident that many financial statement users highly value the emphasis of governmental fund financial statements on the short term. Therefore, the GASB concentrated on resolving the existing problems and making the information as valuable as possible for understanding a government's short-term finances and evaluating its fiscal accountability. Reporting the same type of information that already exists in other financial

statements would diminish the additional value of presenting both the government-wide and governmental fund financial statements.

**5. Are the proposed short-term financial resources measurement focus and accrual basis of accounting the same thing as cash accounting?**

Not at all. In fact, the proposal moves further away from cash accounting by eliminating the concept of availability. Reporting of inflows and outflows would be unrelated to when cash changes hands.

**6. By keeping the governmental funds focused on the short term, does the GASB allow governments to ignore their long-term debt?**

No. The short-term emphasis of the governmental funds is not a case of “out of sight, out of mind.” The information in the governmental fund financial statements is intended to be considered in concert with—not instead of—the longer term information in the government-wide and other financial statements. The often much larger long-term liabilities of a government, including its outstanding debt and pension obligations, clearly are visible in the government-wide financial statements. Likewise, one can easily see the capital assets and other longer term assets at the government’s disposal. If financial statement users are looking exclusively at the governmental fund financial statements and ignoring the other financial statements, then unfortunately they are failing to incorporate vital aspects of government finances that are addressed in the rest of the financial report.

To be clear, it is not the GASB’s mission to tell governments how to manage their finances. The GASB requires governments that follow GAAP to, for instance, report information that compares revenues with expenses, which allows the public to ascertain if governments are living within their means. The GASB does not, however, tell governments that their revenues must exceed their expenses. Another example: The GASB requires that governments report how much they owe to employees for pension benefits but does not require governments to achieve a certain level of funding. Those are matters best decided by a government’s leaders and constituents and are well beyond the GASB’s authority.

The GASB is responsible for establishing standards that lead to governments reporting information that best meets the needs of the public, at a cost that is manageable and justified by the value of the information. Ultimately, the public is paying for that cost through taxes and charges.

**7. Is it true that the short-term focus of the governmental funds could mislead the public about a government’s real financial health and the actual size of its liabilities?**

Again, no. The financial reporting model is intended to be examined as a package, with all financial statements, notes, and RSI informing one’s analysis. The complexity of government finances requires one to consider multiple perspectives to develop a clear and complete picture. The availability of both long-run and short-run financial information supports a thorough understanding of a government’s financial status as of the end of the fiscal year and its financial performance during the fiscal year. Looking exclusively at the governmental fund financial statements and ignoring the other financial statements would produce an underdeveloped and potentially inaccurate picture.

Just as it is not the GASB's mission to tell governments how to manage their finances, the GASB does not instruct readers on how to interpret financial statement information. Although the GASB does [educate the public](#) about the nature and meaning of the information in audited financial statements, only the individual reader can decide what is important to them and whether what they are seeing in the financial statements reflects well or poorly on the government.

## **8. Would the GASB's proposal treat borrowing as revenue?**

No. In fact, the proceeds of bond sales, bank loans, and other forms of borrowing are not reported as revenue in the governmental funds under the *existing* standards. Under the proposal, those proceeds increase fund balance in the governmental funds but are reported as inflows (not revenues) in the resource flows statement. The governmental funds statements are intended to report inflows and outflows of short-term financial resources, not revenues and expenses; that is the purpose of the government-wide financial statements. In the government-wide financial statements, the borrowing proceeds are recorded as an increase in cash and an increase in long-term debt.

Fund balance is the difference between assets and liabilities in the governmental funds. The portion of fund balance that comes from borrowing should not be mistaken for resources that can be used by a government for any purpose, such as paying bills or employee salaries—that would be assigned fund balance and unassigned fund balance. Unspent borrowing proceeds are reported in accounts such as *fund balance restricted for capital projects*; in other words, in this example, those resources can be used only for investment in roads, buildings, equipment, and other capital assets.

## **BACKGROUND**

### **What is the GASB?**

The Governmental Accounting Standards Board or GASB is the private, independent, not-for-profit organization recognized by the accounting industry as the setter of GAAP for state and local governments. The GASB establishes the standards of accounting and financial reporting that comprise GAAP through an open and thorough due process that encourages robust public participation.

### **What is GAAP?**

GAAP is the body of guidance that state and local governments—including cities, counties, school districts, public universities, public hospitals, water and sewer utilities, and so on—follow when assembling the audited annual financial reports that they release to the public.

### **What are governmental fund financial statements?**

All governments that follow GAAP when preparing their financial reports present financial statements that cover all of the financial activities for the entire government—referred to as the *government-wide financial statements*. States, towns, villages, and other governments (including school districts, parks districts, and other special districts) that are financed with a combination of taxes, aid from higher levels of government, and a variety of fees and

charges, present additional financial statements that look at their finances in greater detail—fund financial statements.

The *governmental fund financial statements* report the financial activity of a government's most common services, such as police, fire, street cleaning, parks, building inspections, and so on. They are distinguished from a government's activities that are financed primarily with charges to customers for services—such as water and sewer service—which are reported in detail in the *proprietary fund financial statements*.

## **What are the measurement focus and basis of accounting?**

The measurement focus essentially defines *what types* of assets and liabilities are reported in the financial statements. The basis of accounting essentially determines *when* a government should report assets, liabilities, inflows (generally called revenue), and outflows (generally called expenses) that result from the government's transactions and other events.

All statements except those for the governmental funds utilize an *economic resources* measurement focus and an *accrual* basis of accounting. As a result, those financial statements contain all assets (from cash and short-term investments to capital assets such as buildings and roads) and all liabilities (from payments owed to suppliers to outstanding loans and municipal bonds and long-term amounts owed to employees for their pensions and retiree health insurance). Those financial statement also report all inflows and outflows related to those assets and liabilities.

## **How is information in the governmental fund financial statements different?**

At present, the governmental fund financial statements utilize a *current financial resources* measurement focus and a *modified accrual* basis of accounting. As a result, those financial statements focus on a subset of assets and liabilities—primarily cash, investments, short-term receivables, and short-term payables. They do not include nonfinancial resources such as capital assets or noncurrent items such as outstanding debt and pension liabilities.

The governmental fund financial statement do not simply ignore those longer term items. Whereas the government-wide financial statements add capital assets when they are purchased and reduce the balance of debt as it is paid off, the governmental fund financial statements report the inflows and outflows of the related current financial resources—for instance, the amount owed for buying police cars or the repayment of a bank loan, rather than the cars or the outstanding loan amount.

That narrower focus on the short-term financial health and activity of a government's most basic services complements the broad, long-term perspective of the government-wide financial statements. That focus is intended to address *fiscal accountability*, or whether a government complied with the laws and regulations governing the raising and use of revenue in during the year. The research that the GASB conducted leading up to this project concluded that many financial statement users highly value the information provided in the governmental fund financial statements.

## **If governmental fund financial statements are so valuable, why has the GASB proposed changing them?**

For several reasons, the information in governmental fund financial statements is not as useful as it could be for informing decisions and assessments of a government's fiscal accountability. For instance, the short-term focus of those financial statements is adversely affected because they include items that are not short term, such as receivables that will not be fully collected for more than a year.

There also is inconsistency from government to government in the reporting of revenues due to the concept of *availability*. Specifically, governments generally report revenue for amounts received during the year or soon enough after the end of the year to be *available* to finance the year's expenditures. GAAP stipulates a period of availability of 60 days beyond the fiscal year-end for property tax revenues but leaves it up to governments to select the period for other revenue sources. As a result of governments selecting a variety of periods, including some as long as one year after the end of the fiscal year, some information in the governmental fund financial statements is not fully comparable across governments.