



Get the Concept?

By Michele Mark Levine

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In September 2018, the Governmental Accounting Standards Board (GASB) issued two preliminary views (PV) documents, *Financial Reporting Model Improvements* and *Recognition of Elements of Financial Statements*. The first is a follow up to the invitation to comment (ITC) on the same project, issued in 2016. That project grew out of a reexamination of the current financial reporting model, which was put in place by GASB Statement No. 34, *Basic Financial Statements — and Management’s Discussion and Analysis — for State and Local Governments*, issued nearly 20 years ago. The second PV reexamines part of a conceptual framework PV from 2011, the remaining part of which went on to become GASB Concepts Statement No. 6, *Measurement of Elements of Financial Statements*. This article will provide an overview of the financial reporting “conceptual framework” for U.S. state and local governmental entities, and then look ahead to what may be on its way.

The GASB develops concepts statements in order to:

- Identify the objectives and fundamental principles of financial reporting.
- Provide the Board with the basic conceptual foundation for considering the merits of alternative approaches to financial reporting and help the GASB develop well-reasoned accounting and financial reporting standards.

- Assist preparers, auditors, and users in better understanding the fundamental concepts underlying accounting and financial reporting standards.¹

To date, the GASB has issued six concepts statements, and two more are visible on the horizon (the first of those being the Recognition PV already mentioned). The existing concepts statements address:

1. *Objectives of Financial Reporting*.
2. *Service Efforts and Accomplishments* (superseded by Concepts Statement No. 5).
3. *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*.
4. *Elements of Financial Statements*.
5. *Service Efforts and Accomplishments Reporting* (an amendment of Concepts Statement No. 2).
6. *Measurement of Elements of Financial Statements*.

This discussion will not focus on the service efforts and accomplishments concepts but will discuss GASB Concepts Statements Nos. 1, 3, 4, and 6, as well as what may become Statements Nos. 7 and 8.

Concepts Statement No. 1, *Objectives of Financial Reporting* (Cons. 1) established general purpose external financial statements (GPEFS) and the general purpose financial statements and supplementary information that comprise

them, and, as the purview of the GASB, distinguishing GPEFS from other kinds of financial reports such as budgets and reports to grantors. Cons. 1 identifies *accountability* as the primary purpose of GPEFS and citizens, legislative and oversight bodies, and investors and creditors² as the intended audience. The selection of these groups as the target audience is by no means insignificant. While those involved in investing and loaning money might reasonably be assumed to have familiarity with financial concepts, neither citizens nor the legislators they elect are particularly likely to have any significant expertise in finance or accounting. Cons. 1 also distinguishes between governmental and business-type activities, discusses the roles that budgets and the accounting constructs known as funds play in control and accountability, and notes the significance of governmental investment in non-revenue producing assets.

Each of these elements of Cons. 1 can be seen “in action” in government financial statements. Examples include (1) explanations of the basics of financial statement structure in MD&A, which is aimed at inexperienced users; (2) the structure of government-wide financial statements, which distinguish governmental and business-type activities of a primary government, as well as statements of legally separate entities for which they are accountable (component units); and (3) fund-level financial statements and budgetary comparisons.

Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements* (Cons. 3), identifies four ways in which GPEFR can communicate information:

(1) recognition (recording) in basic financial statements (BFS); (2) disclosure in notes to the BFS — which are considered to be part of the BFS themselves; (3) presentation as required supplementary information (RSI), and (4) presentation as supplementary information, which is included only by those governments that choose to issue a comprehensive financial report rather than only financial statements. It goes on to describe criteria for information to be included by each method and establishes a hierarchy for reporting. Nothing that meets the criteria for recognition in the basic financial statements may instead be disclosed in notes or presented as RSI or other supplementary information (OSI), and nothing that meets the requirements for disclosure in notes may instead be presented in RSI or OSI, etc. Cons. 3 also introduces a slightly different perspective on the financial statements’ expected audience. Unlike Cons. 1’s very broad statement about intended users, Cons. 3 says that the “user is responsible for obtaining a reasonable understanding of government and public finance activities and of the fundamentals of governmental financial reporting, for studying the messages with reasonable diligence, and for applying relevant analytical skills.” This sets a new, higher bar that would conceivably allow for less generic, text-book type explanatory language in MDA, disclosures, and other RSI. However, Cons. 3 was issued after the current reporting model was put in place, and the GASB’s recent reporting model project has not yet proposed changes to disclosures.³

Concepts Statement No. 4, *Elements of Financial Statements* (Cons. 4), defines the term *resource* as “an item that can be drawn on to provide ser-

vices to citizenry.”⁴ The elements of statements of financial position (position statements) are classified as (a) assets, (b) liabilities, (c) deferred outflows of resources, (d) deferred inflows of resources, and (e) net position. Each of the elements of a position statement is defined to identify what reported amounts should include and exclude, except for net position, which is simply a residual amount of all of the other elements of the statement.⁵ The elements of statements of resource flows (flows statements) are classified as outflows of resources and inflows of resources, and each is also defined.

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Concepts Statement No. 6, *Measurement of Elements of Financial Statements* (Cons. 6), identifies two measurement approaches that might be used to assign monetary values to financial statement elements. The first, an *initial-transaction-date-based measurement*, or the *initial amount*, assigns a value based on amounts paid or received when an asset is acquired or a liability incurred. The initial amount might be subsequently adjusted — such as for a proportionate reduction due to the impairment of an asset or the amortization of an historical cost — but those adjustments would need to be related to the value of the initial transaction. The second approach, *current-financial-statement-date measurement*, yields a *remeasured amount* and is based on a value assigned as of the reporting date.⁶ The remeasured amount could be based on the value of the asset or

liability if (hypothetically) it had been the subject of a transaction that took place on the financial statement date, as we see in fair value and acquisition value measurements. In addition to *historical costs* and *fair value*, the statement defines *replacement cost* and *settlement amounts* as the four *measurement attributes*.⁷ Cons. 6 states that initial amounts are more appropriate for measuring assets that are used to provide services, while remeasured amounts are more appropriate for financial assets (that can be converted to cash) and “liabilities about which there is uncertainty as to timing and amount of payments.”⁸

And what about a future Concepts Statement No. 7? Based on the GASB’s current technical plan, the Recognition PV is likely to become the next addition to the Board’s conceptual framework. Remember that *Recognition* is the first rung of the “methods of communication” hierarchy in Cons. 3. In the Recognition PV, the GASB proposes a new hierarchy *within* recognition. Specifically, potential financial statement elements would first be compared to the criteria for assets and liabilities to see if they fall into one of those categories. If not, they would be compared to criteria for deferred outflows and deferred inflows of resources, and lastly to the criteria for inflows and outflows of resources.

The Recognition PV also proposed a new measurement focus (MF)⁹ called the *short-term financial resources MF* (Short-term MF) that would replace the *current financial resources MF* (Current MF) now in use for governmental fund financial statements. The Short-term MF would divide transactions and other events (hereafter referred to jointly as

transactions) into two types. The first, for transactions normally resulting in flows of cash and other short-term financial resources (hereafter referred to jointly as cash flows) *within* one year of the transaction’s inception, are referred to as short-term transactions and classified as current activities for fund activity reporting purposes. The second, for transactions normally resulting in cash flows that extend beyond one year of the transaction’s inception, are called long-term transactions and events, and are reported separately as noncurrent activities. The type of transaction would dictate whether the resulting resource flows (revenues and expenditures, in current terminology) are recognized immediately upon the transaction’s occurrence (short term) or are recognized when the related cash flows are due (long term). For governmental fund financial statements, the recognition hierarchy would only apply to *short-term* assets and liabilities, deferred outflows or deferred inflows of short-term financial resources, and inflows and outflows of short-term financial resources. For all other financial statements, the recognition hierarchy would apply to the broader universe of all *economic* assets and liabilities, deferred outflows and deferred inflows of economic resources, and inflows and outflows of economic resources.

Looking farther ahead to a possible future Concepts Statement No. 8, the GASB recently added a Disclosure Framework concepts project to its technical agenda. This project’s stated intention is “improving the effectiveness of note disclosures in government financial reports.”¹⁰ Specifically, the Board aims to clarify “the notion of essentiality” and to test “new concepts with existing disclosures to gauge their

effectiveness.”¹¹ If the GASB is able to develop robust criteria for determining what is, in fact, *essential* content in note disclosures, that would offer real hope that this and future Boards might exercise restraint to slow the inexorable growth of governments’ financial reports. Together with the Cons. 4 and Cons. 5 and the Recognition PV, this potential statement would complete the conceptual framework as it relates to BFS. Stay tuned, as the first due process document from GASB on this project is currently scheduled for the first quarter of calendar year 2020. ■

Notes

1. GASB Concepts Statement No. 6, *Measurement of Elements of Financial Statements* (Cons. 6), Summary.
2. Investors and creditors include individual and institutional investors and creditors, municipal security underwriters, bond rating agencies, bond insurers, and financial institutions (Cons. 1, paragraph 31).
3. GASB’s PV *Financial Reporting Model Improvements* (Reporting Model PV), paragraph 5, indicates that as part of an exposure draft on the project, GASB “will consider alternatives for enhancing the financial statement analysis component of MD&A, eliminating components that are boilerplate and no longer necessary for understanding the financial reporting model...”
4. Cons. 4, paragraph 6.
5. Cons. 4, paragraphs 8 through 37.
6. Cons. 6, paragraph 6.
7. Cons. 6, paragraphs 35 through 42.
8. Cons. 6, paragraphs 31 through 33.
9. The measurement focus (MF) of financial statements indicates what is being measured, such as financial or economic resources. The same MF was incorporated in the Reporting Model PV, which was issued at the same time as the Recognition PV. Thus GASB is expecting to immediately utilize the concepts in the Recognition PV in standard setting.
10. GASB, *First-Third 2019 Technical Plan*, page 12. The technical plan may be found at gfoa.org/GASB2019TechnicalPlan.
11. Ibid.

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