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ACCOUNTING

Getting a Makeover

GASB Spruces Up a Quarter-Century Old Financial Reporting Model Without Disruptive Change

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A little more than 25 years ago, in June 1999, the Governmental Accounting Standards Board (GASB) adopted GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (GASB 34), which profoundly changed financial reporting by U.S. state and local governments. The statement introduced a new financial reporting model, a paradigm in which government-wide financial statements were added to the

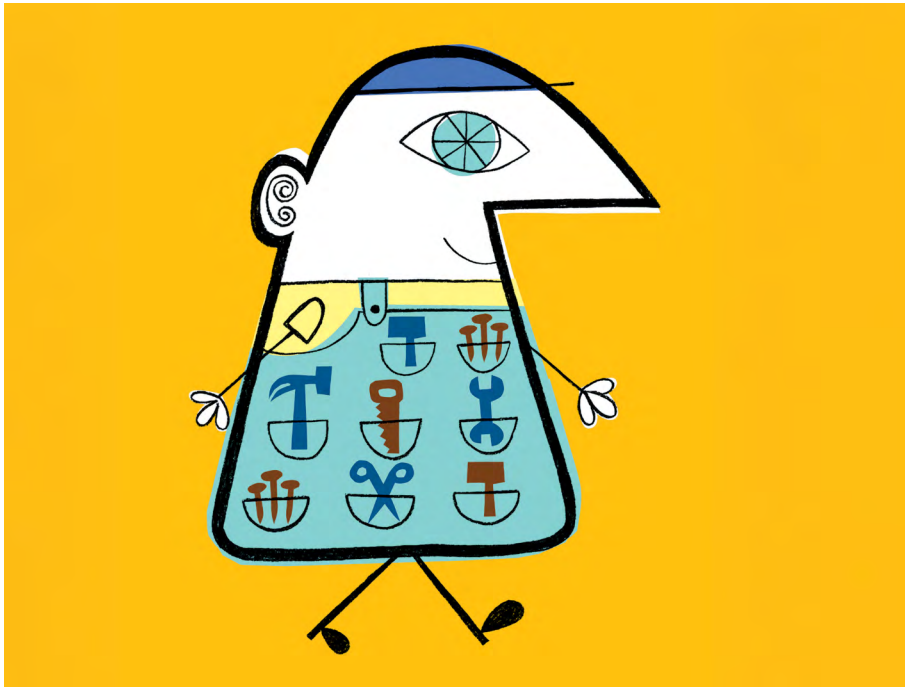
traditional fund-level reports prepared by governments. In the government-wide statements, core governmental operations—those financed primarily by taxes and intergovernmental aid—were reported for the first time using an economic resources measurement focus and the accrual basis of accounting, similar to that used by governments' business-type activities and the private sector accounting on which that was based. While Governmental Accounting Standards Board (GASB) has augmented and amended the authoritative accounting literature [generally accepted

accounting principles, or GAAP] for U.S. state and local governments many times since, that fundamental framework remains significantly unchanged a quarter century later.

On April 17, 2024, GASB voted to approve GASB Statement No. 103, *Financial Reporting Model Improvements* (GASB 103), which makes incremental rather than fundamental changes. Arguably, this standard's most important changes are the ones it didn't make—to the measurement focus and basis of accounting used in financial reporting for governmental funds. However, some meaningful alterations were made.

During the project leading to the issuance of GASB 103, three documents were issued for public comment, an Invitation to Comment (ITC) in December 2016, a Preliminary Views (PV) in September 2018, and an Exposure Draft (ED) in June 30, 2020. All three floated proposals to change the measurement focus (what kind of resources get measured, such as financial resources or economic resources) and basis of accounting (when changes in amounts of resources are recognized, such as whenever there are changes or when those changes affect currently spendable amounts) for governmental funds.

Most recently, the ED had proposed a new *short-term financial resources measurement focus* for governmental funds, under which the effects of short-term transactions would have been recognized as they occurred, and the effects of long-term transactions would have been recognized when payments were due. To distinguish between short-term and long-term transactions, governments would have needed to determine whether more than a year would elapse between the *inception* and *conclusion* of a transaction or—consequently—of a *relevant component* of a transaction. These are all terms used in the ED that GASB seemed to struggle to explain in a way easily understood by readers.



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The governmental fund financial statements that resulted from the ED proposal seemed, in the opinion of many constituents who provided comments and testimony GASB about the ED—including GFOA, to provide information that would have been significantly less useful and more easily manipulated than that in current governmental fund financial statements. Specifically, the use of points in time embodied in contracts and similar agreements [i.e., the inception and conclusion of a transaction] resulted in the timing of cash payments dictating the timing of recognition, rather than any kind of earnings process or assessment of eligibility for non-exchange resources. In this way, the proposed short-term measurement focus had taken on characteristics of cash-basis accounting.

GASB's decision to jettison proposals for a new measurement focus and basis of accounting, as well as related presentational changes to governmental fund financial statements, were welcomed by GFOA and many other interested parties, although it was by no means universally supported.

The most significant changes that were made to governments' annual comprehensive financial reports (ACFRs) in GASB 103 relate to six (6) aspects of the financial reporting model, including:

- I. Content of management's discussion and analysis
- II. Unusual or infrequent items replace extraordinary items and special items
- III. Presentation of proprietary fund financial statements and definitions

for classifying resource flows in those funds

- IV. Presentation of major component units
- V. Presentation of budgetary comparison information, and
- VI. Content of financial trends information in the statistical section of an ACFR

I. Content of management's discussion and analysis (MD&A)

The key changes to MD&A requirements were made to:

- Clarify that the MD&A should be written for an audience that might "not have a detailed knowledge of governmental accounting and financial reporting."¹ This contrasts with the more sophisticated target audience for note disclosures, who "are responsible for (a) obtaining a reasonable understanding of government and public finance activities and of the fundamentals of governmental financial reporting, (b) studying the information with reasonable diligence, and (c) applying relevant analytical skills."²
- Emphasize the primacy of analysis – explanations of why the government's financial position and results of operations changed from one year to the next—in MD&A content, including by:
 - Combining and eliminating certain required content,
 - Adding discussions of significant policy changes, and
 - Clarifying required content of the description of currently known facts, decisions or conditions that are expected to have a significant effect on financial position or produce significant differences from current period results of operations, including, as applicable:
 - Discussions of economic and demographic changes,
 - Factors used to develop the next year's budget, and
 - Expected changes in budgetary net position or budgetary fund balance, and
- Help to avoid unnecessary redundancy in the analysis provided.

As current budgetary comparison reporting requirements (discussed further, below), require only that budgetary and GAAP revenues and expenditures are compared, the requirement that MD&A discuss expected changes in budgetary net position or budgetary fund balance will indirectly require governments to understand and explain differences between GAAP and budgetary-basis balances. For some governments, this will be the first time the differences between GAAP and budgetary balances will be analyzed and quantified and will require collaboration between accounting and budgeting officials where the functions are distinct.

See Exhibit 1 for a comparative summary of MD&A content in current GAAP and under GASB 103.

II. Unusual or infrequent items replace extraordinary items and special items

The purpose of current requirements for identifying and reporting extraordinary and special items in government's operating statements (i.e., government-wide statement of activities; governmental funds statement of revenues, expenditures, and changes in fund balances; and proprietary funds statement of revenues, expenses and changes in fund net position), is to call attention to the nonrecurring nature of certain significant resource flows that occur in a reporting period and to make the remaining flows amounts useful for trend analysis by excluding the same.

While retaining the existing definitions for unusual and infrequent items, GASB 103 requires only one classification for items that are either unusual or infrequent, rather than both (now extraordinary items) or only one of the two but also under management's control (now special items).³ The required note disclosures will provide additional detail, including whether an unusual or infrequent item is within management's control. Additionally, GASB 103 clarifies that unusual or infrequent items should be reported gross, rather than netted, so readers can easily see the amounts of inflows and outflows resulting from these items.

EXHIBIT 1 | Summary of MD&A content changes

COMPARISON OF MD&A REQUIREMENTS – GASB 34 VS. GASB 103	
Current (GASB 34, as amended)	GASB 103
1. Discussion of the basic financial statements	1. Overview of the financial statements
2. Condensed financial information	2. Financial summary
3. Analysis of the government's overall financial position and results of operations	3. Detailed analyses
4. Analysis of the balances and transactions of individual funds	
5. Description of capital asset and long-term debt activity	4. Significant capital asset and long-term financing activity
6. Currently known facts, decisions, or conditions of future significance	5. Currently known facts, decisions, or conditions
7. Analysis of budgetary variations	N/A [Moved to notes to RSI other than MD&A]
8. Discussion of infrastructure accounted for using the modified approach	N/A

III. Presentation of proprietary fund financial statements and definitions for classifying resource flows in those statements

For years governments have struggled with the idea that so-called *operating* subsidies are to be reported as *nonoperating* revenue in proprietary funds, as they are not generated in exchange for providing the fund's core services, even though the subsidies are intended to cover costs of doing so. Preparers of financial statements of transit and similar business-type operations have expressed discomfort reporting "operating losses" when comparing only operating revenues – excluding operating subsidies – to operating expenses, believing the implication is that their revenues fell short, even though they were never intended to cover all costs.

To help alleviate the concerns and improve consistency, GASB 103 defines nonoperating revenues and expenses, and indicates that all other revenues

and expenses should be reported as operating revenues and expenses. Paragraph 13 of GASB 103 indicates that, except when the activities in these categories are the fund's principal operations, the following are nonoperating revenues and expenses:

- a. Subsidies received and provided
- b. Contributions to permanent and term endowments
- c. Revenues and expenses from financing
- d. Resources received from the disposal of capital or inventory assets
- e. Investment income and expenses

Moreover, GASB 103 changes the format for the proprietary funds statement of revenues, expenses and changes in net position to separately break out noncapital subsidies, a different and potentially less-confusing term for operating subsidies, from other nonoperating revenues

and expenses. In addition to displaying operating income [loss], the new format includes an additional subtotal for *operating income [loss] and noncapital subsidies* together, before displaying the other nonoperating revenues and expenses.

Of course, it helps if folks can agree on what exactly a subsidy is, so GASB 103 (paragraph 14) defines subsidies as being:

- f. Resources received from another party or fund (1) for which the proprietary fund does not provide goods and services to the other party or fund and (2) that directly or indirectly keep the proprietary fund's current or future fees and charges lower than they would be otherwise

- g. Resources provided to another party or fund (1) for which the other party or fund does not provide goods and services to the proprietary fund and (2) that are recoverable through the proprietary fund's current or future pricing policies

- h. All other transfers.

See exhibit 2 for an example of a partial proprietary fund statement of revenues, expenses and changes in fund balance using the new format.

IV. Presentation of major component units

Unlike the identification of major governmental and enterprise funds where there is a quantitative threshold above which

funds need to be reported as major funds (while professional judgement may be used to report additional major funds), the identification of major component units (CUs) is purely a matter of professional judgment, "based on the nature and significance of its relationship to the primary government."⁴ Once identified, major CUs need to be displayed either (1) separately on the face of the government-wide statement of net position and statement of activities (preferred) or (2) in combining statements of major component units, following the fund financial statements. GASB 103 removes the current option of instead including condensed statements for major CUs in note disclosures.

V. Presentation of budgetary comparison information

GASB 103 requires that mandatory budgetary comparison information, for a government's general fund and its major special revenue funds that are the subject of legally adopted annual or biennial budgets, be presented as Required Supplementary Information (RSI). This removes the current option to include the comparisons as basic financial statements. GASB 103 also added requirements for the presentation of variance columns in these RSI schedules, showing the differences between (1) original and final budgets, and (2) final budgets and actual results.

While anecdotal evidence suggests that a large majority of governments currently include the information in RSI, GFOA has long recommended its inclusion in basic financial statements, which are audited. GFOA's position has been that adherence to the budget is key to accountability and is of paramount importance to most government stakeholders, and thus the comparisons should have been included within audited financial statements to provide public confidence in the reported amounts.⁵ GASB, however, concluded that the budgetary comparisons do not meet their conceptual requirements to be included in basic financial statements, and that the current optional presentation resulted in undesirable inconsistency in reporting.⁶

For some governments, this will be the first time the differences between GAAP and budgetary *balances* will be analyzed and quantified and will require collaboration between accounting and budgeting officials where the functions are distinct.



EXHIBIT 2 | Example partial statement of Enterprise Fund Statement of Revenues, Expenses, and Changes in fund Net Position in accordance with GASB 103 requirements

Additional income (loss) amounts reported		Business-type Activities			Governmental Activities
		Water	Transit	Total Enterprise Funds	Internal Service Funds
Operating income (loss)	Operating income (loss)	1,563,845	(4,956,792)	(3,392,947)	(412,064)
NEW: Operating income (loss) and operating subsidies	Noncapital subsidies				
	Intergovernmental	10,967	390,474	401,441	-
	Transfers in	-	3,728,209	3,728,209	-
	Total noncapital subsidies	10,967	4,118,683	4,129,650	-
	Operating income (loss) and noncapital subsidies	1,574,812	(838,109)	736,703	(412,064)
Other nonoperating revenues (expenses):					
	Investment earnings	276,191	10,819	287,010	139,530
	Capital contributions	3,615	1,174,511	1,178,126	-
	Loss on disposal of property	(2,278)	(88,031)	(90,309)	-
	Interest expense	(446,820)	-	(446,820)	-
	Total other nonoperating revenues (expenses)	(169,292)	1,097,299	928,007	139,530
Income (loss) before Unusual or infrequent items, if applicable (not shown)	Change in net position	1,405,520	259,190	1,664,710	(272,534)
	Increase (decrease) in net position	1,405,520	259,190	1,664,710	(272,534)
	Net position - beginning of year	22,824,003	9,378,935	32,202,938	4,035,613
	Net position - end of year	\$24,229,523	\$9,638,125	\$33,867,648	\$3,763,079
Adjustment for the net effect of the current year activity between the internal service funds and the enterprise funds.				(20,603)	
Changes in net position of business-type activities				\$ 1,644,107	


The notes to financial statements are an integral part of this statement.

VI. Content of financial trends information in the statistical section of an ACFR

Proprietary funds statements of revenues, expenditures, and changes in fund net position are required by GASB 103 to be presented using different categories, as discussed above. The statement also makes parallel changes to the content of the financial trend information in the statistical section of ACFRs, such that the statements and the trend information will continue to articulate. The new statistical section presentation requirements apply to the stand-alone reports of governments engaged in business-type governments but no governmental activities, regardless of whether they report only business-type

or both business-type and fiduciary activities.

The ED (discussed earlier) had proposed a phased implementation where larger governments would be required to implement before smaller governments, but the final statement's greatly simplified implementation will be required of all governments on the same schedule. Specifically, governments are required to implement GASB 103 for their first fiscal years beginning after June 15, 2025, with governments encouraged to implement sooner. Governments are required to apply the provisions of GASB Statement No. 100, Accounting Changes and Error Corrections in their transition.⁷ By virtue of GASB's decision not to make

changes to governmental fund reporting, we expect that the implementation of GASB 103 will be significantly less disruptive than the implementation of GASB 34 was approximately 25 years ago. 



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¹ GASB 103, paragraph 4.

² Paragraph 8 of GASB Concepts Statement No. 7, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements: Notes to Financial Statements*

³ GASB Cod. Sec. 1800.150 defines an event or transaction that is unusual in nature as being one that "is abnormal and significantly different from the ordinary and typical activities of the government," and GASB Cod. Sec. 1800.151 defines one that is an infrequent occurrence as being "not reasonably expected to recur in the foreseeable future."

⁴ GASB Best Practice Budgetary Comparisons as Part of the Basic Financial Statements.

⁵ See GASB 103 basis for conclusion paragraphs B48 through B52.

⁶ See the In the August 2022 edition of *Government Finance Review* for a refresher on GASB 100 requirements.