

# A Timeless Question about the Timeliness of Financial Reporting

By Michele Mark Levine

Timely financial reporting is important, which is why GFOA requires that applicants to our Certificate of Achievement for Excellence in Financial Reporting submit their CAFRs within six months of their fiscal year-end.

The Governmental Accounting Standards Board (GASB) Concepts Statement 1, *Objectives of Financial Reporting*, states that to be effective, information in financial reports must have certain characteristics, including "understandability, reliability, relevance, timeliness, consistency and comparability."[1] Framed right in the center of the list is timeliness. GFOA too has long recognized the importance of timely financial reporting, requiring that applicants to our Certificate of Achievement for Excellence in Financial Reporting (CAFR Award program) submit their comprehensive annual financial reports (CAFRs) no later than six months after the end of their fiscal years.[2] More practically, GFOA has a best practice with suggestions for governments to help them to plan for, prepare, have audited, and issue financial statements and CAFRs in the shortest timeframe possible.[3]

Many people ask why large multinational corporations are often able to issue financial statements in less time than it takes a small local government. After all, the total dollar amount and the geographic area of activities, the number of currencies in which business is conducted, and innumerable other indicators make the local government appear considerably less complex. Timeliness has been examined by GASB[4] and by academics, and has been the subject of scrutiny from none other than the chairman of the Securities and Exchange Commission.[5] But looking beneath the surface quickly reveals many issues, which are specific to government, that cause or contribute to the longer production timeframe for government financial statements. Let's discuss a few of them here.[6]

**Diversity of Operations.** Every type of activity involves nuances of recognition and measurement of the related assets, liabilities, deferred items, revenues, and expenses/expenditures (all the more so when the measurement focuses and bases of accounting differ, as discussed below). Even a small general-purpose government is likely engaged in a wide array of activities — public safety and judicial, health and welfare, transportation, recreation, infrastructure, and public records, to name a few. In contrast, even large corporations are often dedicated to a group of closely related products and services, such as energy, technology, or food processing and distribution.

**Multiple Measurement Focuses and Basis of Accounting.** Unlike private-sector financial reporting, government financial statements prepared in accordance with generally accepted accounting principles (GAAP) are often prepared on three separate measurement focuses and bases of accounting: 1) the economic resources measurement focus and the accrual basis of accounting, for all financial statements other than governmental funds statements; 2) the current financial resources measurement focus and the modified accrual basis of accounting for all governmental funds financial statements; and 3) the government's own budgetary basis of accounting for the general fund and those major special revenue funds with legally enacted annual or biennial budgets. Governments often maintain their accounting records on a cash, budgetary, and/or modified accrual basis of accounting throughout the year — as those are likely used for any interim reporting — and only convert to the other bases required for GAAP financial statements at year-end. This conversion process can be time consuming and may require the reconstruction of transactions that occurred during the fiscal year (such as those related to capital assets and long-term debt) before the statements are prepared.

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**Lack of Control of Component Units.** While a large corporation may have many subsidiaries with financial statements that must be consolidated for financial reporting, the parent company will have control over those subsidiaries, as control is the factor that determines which entities are consolidated. This is not, however, always the situation with a government's component units. GASB's criteria for determining which legally separate entities must be incorporated into a government's financial statements is based on accountability of elected officials, a more nebulous concept that may result in a government's needing to incorporate the financial statements of an entity over which it has only limited control (e.g., having control over the entity's budget but not its governing body or its management), when the entity has the potential to financially benefit or burden the government. In such cases, the government may not be able to compel the timely preparation, audit, and submission of a component unit's financials for incorporation into the primary government's own financial statements or CAFR.

**Lack of Specialized Financial Reporting Staff.** While a large publicly traded corporation will have the dedicated financial reporting staff necessary to prepare the quarterly financial statements required for internal use and mandated external reporting, many governments' interim financial reporting is limited to budgetary-basis schedules rather than GAAP-based financial statements that are prepared and audited only once a year. Many of the staff members involved in preparing a government's year-end financial statements are engaged in other budget, accounting, or finance functions throughout the year and must therefore make time for and re-learn these infrequently performed procedures.

**Defined Benefit (DB) Pensions and other Postemployment Benefits (OPEB).** Most local governments participate in one or more DB pension and OPEB plans, which require annual actuarial valuations and/or roll-forwards of valuations to measurement dates, while most private-sector employers offer only defined contribution pension plans. The limited number of actuaries qualified to prepare DB pension — and especially DB OPEB — valuations can result in significant delays of the reports needed to prepare and audit a government's financial statements. Moreover, as many local governments participate in statewide DB plans, the delay of actuarial reports and, in turn, of the audited financial statements of a single multiple-employer DB plan can cascade into delays of financial statements and audits for dozens or even hundreds of local governments.

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**Federal Funds Single Audit and other Additional Reporting Requirements.** Governments that expend more than $750,000 from all sources of federal grant funds in a year are required to prepare a schedule of expenditures of federal awards and to undergo a single audit that includes extensive grant requirement compliance testing performed in accordance with government audit standards (GAS), as further discussed below. Additionally, many local governments are required by states and/or other grantors to provide supplementary information schedules and reports, either in their audited financial statements or separately, but shortly after the end of their fiscal year, when they compete for the limited time and attention of accounting and financial reporting staff.

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**Audit Timeliness.** The highly specialized nature of GAAP for state and local governments, and the similarly specialized requirements of GAS and of the federal funds single audit work, which is subject to GAS, also frequently cause delays in issuance of governments financial statements and CAFRs. As with actuaries, there is a limited number of certified public accounting (CPA) firms with the skills and experience to perform audits of local governments. Governments, being price-sensitive, are often less profitable — and therefore lower priority — clients for CPA firms, which may defer working on those audits until they've tended to their private-sector tax, audit, and consulting work. In states where annual audits of local governments are conducted or subject to pre-issuance approval by state auditors, the volume of governments with the same fiscal year end may cause a log jam for state auditor offices, further delaying the issuance of audited financial statements for some or all of the local governments.

Of course, many of these factors — and numerous others — that negatively affect the timeliness of financial reporting by governments come down to resource constraints. If governments were willing and able to invest in more dedicated staff, pay more for audit and actuarial services, and incentivize or compensate component units to do the same — not to mention risk compromising the reliability of the financial statements — the turn-around time for financial statements could be shortened. However, when compared to the ever-present pressure to provide more direct services (think of the list above, beginning with public safety) with stable or even reduced resources, the operative question becomes: Is the opportunity cost — measured in police officers, teachers, road quality, etc. — of quicker financial statement issuance really worth it?[7]

**Notes**

1. Governmental Accounting Standards Board (GASB), 2019-2020 *Codification of Governmental Accounting and Financial Reporting Standards* (Cod.), "Appendix B — GASB Concepts Statements, Concepts Statement No. 1, Objectives of Financial Reporting, as amended," (Appendix B), paragraph 62.
2. Eligibility requirements for the CAFR Award Program can be found on GFOA's website at gfoa.org/CAFR-eligibility.
3. GFOA Best Practice, *Timely Financial Reporting*, 2008. (gfoa.org/timely-financial-reporting).
4. See GASB's 2011 (gasb.org/jsp/GASB/Document_C/DocumentPage&cid=1176158316214) and 2019 (gasb.org/jsp/GASB/Document_C/DocumentPage&cid=1176171975910) research reports on the topic.
5. "The Timeliness of Financial Reporting by State and Local Governments Compared with the Needs of Users, GASB Research Brief, 2011. sec.gov/news/public-statement/statement-clayton-120618
6. See GFOA's resource, *Timeliness of Financial Reporting* (gfoa.org/timeliness-financial-reporting) for a more comprehensive listing of contributing factors.
7. There is evidence that debt service cost savings are associated with more timely financial statements (see, for example, Trent S. Henke and John J. Haher, "Government Reporting Timeliness and Municipal Credit Market Implications," *Journal of Governmental and Nonprofit Accounting*, 2016, at aaapubs.org/doi/pdf/10.2308/ogna-51601). However, as there are many factors that affect bond yields, it is virtually impossible for an individual government to demonstrate a specific and measurable — and thus *budgetary* — savings from timelier financial reporting, whereas the budgetary impact of the spending necessary for the improvement is easily quantifiable.

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