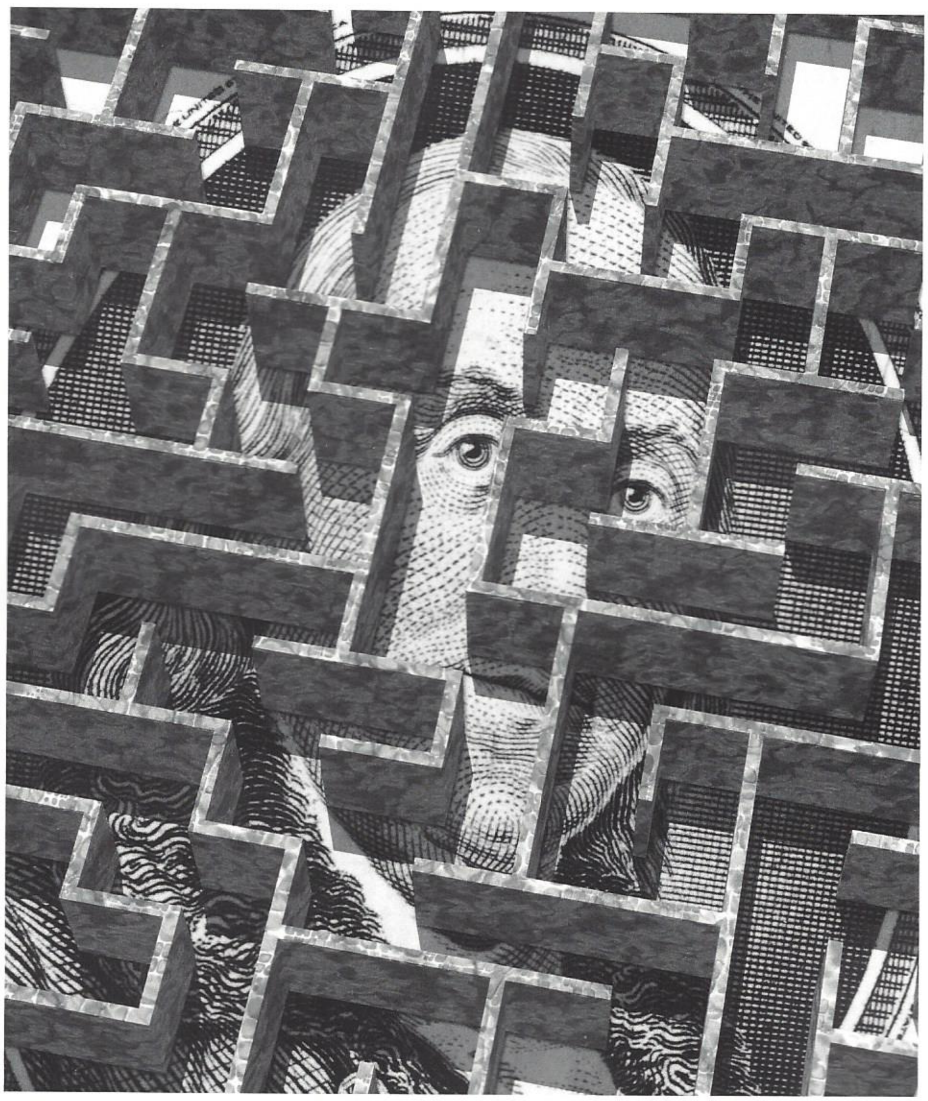
Why Is GASB 34 Such a Big Deal?

by Bill Statler

In June 1999, the Governmental Accounting Standards Board (GASB), which sets "generally accepted accounting principles" (financial reporting rules) for all state and local governments, adopted the most sweeping financial reporting changes in its history. The earliest of these changes will go into effect next year.



Known as *Statement No. 34: Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments,* this represents a fundamental revision of the current financial reporting model, which has been in place since 1979. While a number of significant changes were made — after all, the statement is more than 400 pages long — two major changes are described below.

Two Kinds of Financial Statements. Two distinct forms of information will be provided in the basic financial statements:

1. **Governmentwide statements.** These are consolidated financial statements on a full accrual basis of accounting for all of a city's operations. The governmentwide statements will not be presented on a fund basis; instead, fiscal operations will be organized into two major activities: governmental and business-type. The statements have a "net asset" focus, and exclude interfund transactions (such as internal service funds) and fiduciary funds. Expenses (which may include allocated indirect costs) are to show both gross and net of related revenues, such as fees and grants.
2. **Fund statements.** To meet stewardship and accountability concerns, financial statements will also be presented on a fund basis, but not using the same basis of accounting as the governmentwide statements for governmental funds.

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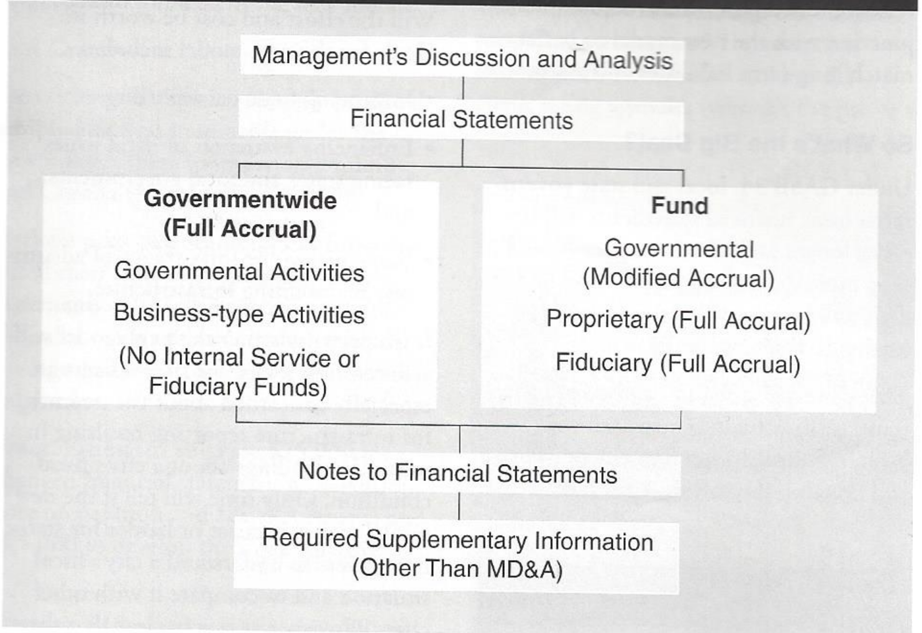
Flow of Basic Financial Statements Under the New Model



Because there are differences in the basis of accounting and scope of transactions, there will be significant differences between these two financial statements, but they are not obvious. For this reason, a detailed reconciliation between them will be required as part of the audited basic financial statements.

Focus on Major Funds. In the "fund section" of the report, statements will focus on major (large) individual funds, rather than on consolidated fund types.

Required Supplementary Information. There are two new elements to RSI.

1. **Management's discussion and analysis (MD&A).** Many cities already prepare a comprehensive transmittal memorandum as part of their annual financial report. For some of them, this new MD&A requirement may not pose a significant additional work element. However, due to the addition of governmentwide statements (and required topics), the scope (and related work effort) will certainly increase. Additionally, since this is now a required part of the basic financial statements, audit costs will probably increase.
2. **Budget reporting.** Comparisons of budget-to-actual results for the governmental funds are no longer required as part of the basic financial statements — but will be required supplementary information. And there is an added requirement: both the original and final budget must be presented.

Basic Financial Statements. The chart above summarizes the flow of basic financial statements under the new model:

No Account Groups. General fixed assets and long-term debt will no longer be shown as account groups. They are now to be included in the governmentwide financial statements as assets and liabilities.

Depreciation for Governmental Activities. Under the current reporting model, depreciation is not recorded for governmental capital assets, such as those purchased through the general fund. The traditional rationale for this is an appropriate focus on "available spendable resources," which is based on the simple fact that programs and projects cannot be funded through the budget process based on the current net value of fixed assets. However, in order to allocate the cost of these assets over their useful lives, the new model requires depreciation of general fixed assets. Correspondingly, the governmentwide financial statements should not show capital expenditures, (nor should they show the principal component of debt-service payments as expenditures) but the fund-based statements will.

Recording Infrastructure as Capital Assets and Expensing Them Through Depreciation. Current accounting principles do not require the reporting of infrastructure costs such as roads, bridges, storm drains, street lights and traffic signals as capital assets — not because they aren't major community investments, but because they are immovable, and of value only to the government.

The new reporting model requires that infrastructure be reported at its "historical" (not current) value, then depreciated like other assets as discussed above. (There are several complicated options for how to do this, including not depreciating infrastructure assets if there is an adopted maintenance plan and assets are being maintained in accordance with that plan.) Nearly all municipal finance officers across the country vigorously opposed this change as being very expensive with limited practical value.

Notes to the Financial Statements. Already long and complex, these will have to become even more complex to meet the new model's disclosure requirements.

Will City Finances Look Better Or Worse?

It depends on the unique circumstances of each city. At the fund level, it should make little difference. At the governmentwide level, showing infrastructure assets on the balance sheet may improve the equity position in some cases. For others, the inclusion of long-term debt and other liabilities may reduce equity. For the handful of cities that have

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prepared sample statements under the new model, the answer seems to be: no better or worse, just different.

Implementation

As shown in the table below, the effective date for the new model varies, depending on the financial size of the agency and its fiscal year. (The chart assumes a fiscal year beginning July 1 and ending June 30). Also, there are different effective dates for implementing the new model and prospective reporting of infrastructure (assets added or deleted from the effective date of the new model) versus retroactive reporting of infrastructure back to at least 1980.

Cities that have long-term debt for infrastructure assets will probably want to retroactively report infrastructure in conjunction with the new model to better match long-term liabilities and assets.

So What's the Big Deal?

Under GASB 34, local and state government basic financial statements will become longer and more complex — and thus more difficult to prepare and audit. This will be especially true when converting to the new model.

This increased difficulty and complexity translate directly into increased costs — both one-time during implementation and ongoing thereafter — for staff resources, as well as audit fees and consultant services.

Will the effort and cost be worth it? Goals for the new model include:

- Improving financial reporting;
- Enhancing awareness of fiscal issues facing states and local governments; and
- Recognizing the importance of adequately maintaining infrastructure.

It is unclear whether the new model will achieve these goals. Finance officers are especially concerned about the potential for infrastructure reporting resulting in misunderstandings about a city's fiscal condition. Only time will tell if the new model makes it easier or harder for statement users to understand a city's fiscal situation and to compare it with other cities. However, it is very clear that these will be expensive changes to make.

How much will it cost? Again, the short answer is, it depends on the:

- Size and complexity of the city's operations;
- Finance staff resources;
- Age of the infrastructure; and
- Availability of reliable information about current infrastructure systems.

For communities with relatively new infrastructure, this may be a less difficult undertaking than in older cities; and implementation and ongoing support may be easier for cities that have already extensively documented their infrastructure through the use of geographic information systems (GIS) or established maintenance systems, such as pavement management plans.

In evaluating costs, cities need to consider both the one-time and ongoing costs of:

- Preparing the additional financial information;
- Developing and maintaining the infrastructure data; and
- Auditing the results.

Effective Dates for GASB 34 Implementation

Total Revenues	Basic Model (Prospective Infrastructure Reporting)	Retroactive Infrastructure Reporting
	Effective for Fiscal Year	
$100 million or more	2001–02	2005–06
$10 to $100 million	2002–03	2006–07
Under $10 million	2003–04	Not Required

In most cases, at least initially, outside accounting and engineering resources will be needed to implement the new model.

Two Case Studies

Two cities in California recently prepared sample financial statements under the new model: Tracy (population 54,200) and Corona (population 123,000).

In these pilot case studies, local firms donated their time to prepare the sample statements. The following estimates of the value of this pro bono work exclude the significant staff work that also was required.

Tracy. Estimated costs are $25,000 for changed financial statement presentation, note preparation and MD&A review; and $25,000 to develop the infrastructure data.

Corona. Estimated costs are $30,000 for changed financial statement presentation, note preparation and MD&A review; and $11,000 to develop the infrastructure data. (As noted below, this work was built on a recently completed, comprehensive fixed asset inventory that cost $55,000 to complete).

These implementation costs, ranging from $40,000–$50,000, should be considered "order of magnitude" estimates and best-case examples for comparably sized cities for the following reasons. Tracy and Corona started from a solid financial statement base. They already prepare their annual financial reports in accordance with the high standards of the programs for excellence in financial reporting developed by the Government Finance Officers Association (GFOA) and the California Society of Municipal Finance Officers (CSMFO). Their infrastructure assets are relatively new, and GIS applications are in place. Tracy has a comprehensive pavement management system, and Corona had just completed a $55,000 appraisal of its fixed assets, providing a solid staring point.

Why Implement it?

If GASB 34 is going to be so difficult to implement, and the benefits unclear, why do it?

The new model is supported by a number of users and professional associations. The National Association of State Auditors, Comptrollers and Treasurers has endorsed the new model, as have the credit rating agencies (who are the primary users of these reports). Many public works officials believe the new reporting model will result in a better understanding of infrastructure needs. And a number of well-respected municipal

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For More Information

The California Society of Municipal Finance Officers (CSMFO) website at www.csmfo.org includes a compendium of background articles on GASB 34 implementation, which can be accessed from the home page using the "GASB 34 Resources" link. CSMFO's annual conference, which will be held in Feb. 25–27, 2001, in San Jose, will include a pre-conference session on Feb. 24 about GASB 34 and a track throughout the conference on issues related to GASB 34. For more information about the conference, visit the website or phone (916) 658-8210.

At the League's annual conference, Sept 7–9, a session about "GASB 34: What Is It? And Why Is It Such A Big Deal?" was filled to capacity. Audio tapes of the session are available from Five Star Conference Services at (800) 350-8273.

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finance professionals think the new reporting model better tells a city's fiscal story, and is a significant improvement over the current model.

GASB is generally accepted. This is probably the most compelling reason for implementing the new model. GASB is the acknowledged authoritative body in setting generally accepted accounting principles (GAAP) for local and state agencies. Maintaining citizen confidence in city stewardship of public assets requires credibility and integrity in municipal accounting and financial reporting systems. And preparing audited financial statements in accordance with industry standards is an essential foundation in gaining and sustaining that trust.

For this reason, despite its reservations about some of the changes in the new model, CSMFO, which represents more than 1,000 local government finance professionals throughout the state, has strongly encouraged its members to implement GASB 34.

Summary

GASB 34 represents a major change in financial reporting for local and state governments. While there are concerns about the value of some of these changes (most notably infrastructure reporting), there is widespread agreement that cities should implement these changes in order to prepare audited financial statements in accordance with generally accepted accounting principles.

For many cities, implementing the new model should not be an overwhelming task. But for all cities, it will mean careful planning, staff training and allocating the resources necessary to successfully make this change.