

## Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis— for State and Local Governments*

Statement 34 establishes new requirements for the annual financial reports of state and local governments. The Statement was developed to make annual reports easier to understand and more useful to the people who use governmental financial information to make decisions (or who may do so in the future): legislators, their staff, and members of oversight bodies; investors, creditors, and others who provide resources to governments; and citizen groups and the public in general.

Statement 34 is firmly rooted in GASB Concepts Statement No. 1, *Objectives of Financial Reporting*, published in 1987. Some of those objectives affirm the importance of the information governments currently include in their annual reports, whereas others call for new information to fulfill the unmet needs of decision makers. Statement 34 strives to meet those objectives by requiring governments to retain much of the current information, in addition to offering new and different financial data. The Statement accomplishes many of the objectives set forth in 1987, and lays the groundwork for meeting the remaining objectives in the future.

### Debuting New Information

The financial managers of governments are knowledgeable about the transactions, events, and conditions that are reflected in the government’s financial report and of the fiscal policies that govern its operations. For the first time, those financial managers will share their insights in a required management’s discussion and analysis (MD&A) that gives readers an *objective* and *easily readable* analysis of the government’s financial performance for the year.

The MD&A will provide an analysis of the government’s overall financial position and results of the previous year’s operations to assist the users of financial statements to assess whether the government’s finances have improved or deteriorated. The analysis will include a comparison of the current year to the prior year based on government-wide financial information about assets, liabilities, revenues, and expenses. In addition, the analysis will explain significant variations in fund-based financial results and budgetary information, and will describe capital asset and long-term debt activity during the year. The MD&A will conclude with a description of currently known facts, decisions, or conditions that are expected to have a significant effect on the government’s future financial position and operations.

### Government-wide financial statements

Financial managers will be better equipped to provide the MD&A analysis because for the first time the annual report will include financial statements prepared using *full accrual* accounting for *all of the government’s activities*—not just those that cover costs by charging a fee for services, as was previously required. Most governmental utilities and private-sector companies currently use full accrual accounting. This approach includes not just current assets and liabilities (such as cash and accounts payable, respectively) but also capital assets and long-term liabilities (such as buildings and infrastructure, including bridges and roads, and general obligation debt). Accrual accounting also reports *all* of the revenues and costs of providing services each year, not just those received or paid in the current year or soon thereafter.

Full accrual accounting will help governments meet two important objectives of financial reporting from Concepts Statement 1. It generates the information users need to help them assess:

- Whether current-year citizens paid for the services they received in the current year, or if the costs of services were shifted to future-year citizens;
- Whether a government’s financial position has improved or deteriorated as a result of the year’s operations.

In addition, the government-wide statements should help users assess the extent to which the government has invested in capital assets, including infrastructure. In short, the new financial statements should give government officials a new way to demonstrate their stewardship in the long term in addition to the way they currently demonstrate the short-term fund or budgetary focus.

The new government-wide *statement of activities* reports expenses and revenues in a format that focuses on the *net cost* of each of the government’s functions. The expenses of individual functions are compared to the revenues generated directly by the function (for instance, through user charges or intergovernmental grants). This will allow users to see the financial benefit or burden that each function places on the constituency of the reporting government. In other words, it will show the extent to which secondary education or public safety, for example, either contributes to or draws from the general revenues of the government.

(see page 3)

## Components of the New Financial Statements

Statement 34 establishes that the basic financial statements and required supplementary information (RSI) for general purpose governments will consist of:

### Management's discussion and analysis

MD&A will introduce the basic financial statements and provide an analytical overview of the government's financial activities. Although its status for reporting and auditing purposes is RSI, MD&A will be presented *before* the basic financial statements.

### Basic financial statements

- *Government-wide statements*, consisting of a *statement of net assets* and a *statement of activities*. Prepared using the economic resources measurement focus and accrual basis of accounting, these statements will report all of the assets, liabilities, revenues, and expenses of the government. Each statement will distinguish between the governmental and business-type activities of the primary government and between the total primary government and its discretely presented component units by reporting each in separate columns. Fiduciary activities, whose resources are not available to finance the government's programs, will be excluded from the government-wide statements.
- *Fund-based financial statements*, consisting of a series of statements that provide information about the government's major and nonmajor governmental and enterprise funds. Fund-based financial statements also will report information about a government's fiduciary funds and discretely presented component units that are fiduciary in nature.
  - *Governmental fund* financial statements—including the general fund, and special revenue, debt service, capital projects, and permanent funds—will be prepared using the current financial resources measurement focus and modified accrual basis of accounting.
    - Required governmental fund statements are a *balance sheet* and a *statement of revenues, expenditures, and changes in fund balances*.
  - *Proprietary fund* financial statements (including enterprise funds and internal service funds) and *fiduciary fund* financial statements will be pre-

pared using the economic resources measurement focus and the accrual basis of accounting.

- Required proprietary fund statements are a *statement of net assets*, a *statement of revenues, expenses, and changes in fund net assets*, and a *cash flows statement*.
- Required fiduciary fund statements are a *statement of fiduciary net assets* and a *statement of changes in fiduciary net assets*.
- *Notes to the financial statements*. The notes will provide information that is essential to a user's understanding of the basic financial statements.

### Required supplementary information

- A budgetary comparison schedule comparing original, final, and actual information on the budgetary basis for the government's general fund and major special revenue funds is required. Governments are also required to present other types of data in RSI based on previous GASB pronouncements.
- Governments that elect to use the modified approach to reporting infrastructure will be required to disclose in RSI: the assessed physical condition of infrastructure assets (governments will perform such assessments at least every three years, and will disclose the results of at least the three most recent condition assessments); descriptions of the criteria the government uses to measure and report asset condition; the condition level at which the government intends to maintain the assets; and a comparison of the annual dollar amount estimated to be required to maintain and preserve the assets at the condition level established by the government, with the actual expenses for at least the last five years.

Special purpose governments that are engaged in only governmental activities (such as some library districts) or that are engaged in both governmental and business-type activities (such as some school districts) generally will be reported in the same manner as general purpose governments. Special purpose governments engaged only in business-type activities (such as a utility) should present the financial statements required for enterprise funds as well as MD&A and other RSI.

## Important features of the government-wide financial statements

- Governments will report all capital assets, including infrastructure, in the government-wide *statement of net assets* and will report depreciation expense—the cost of “using up” capital assets—in the statement of activities.
  - Infrastructure assets are not required to be depreciated if (1) the government manages those assets using an asset management system that has certain characteristics and (2) the government can document that the assets are being preserved approximately at (or above) a condition level established and disclosed by the government. Qualifying governments will make disclosures about infrastructure assets in required supplementary information (RSI), including the physical condition of the assets and the amounts spent to maintain and preserve them over time.
- The net assets of a government will be broken down into three categories—*invested in capital assets, net of related debt; restricted; and unrestricted*.
  - Statement 34 defines restricted net assets as those whose use is constrained by law (for instance, by constitutional provisions or enabling legislation) or externally (such as by creditors or the laws of other governments).
- The statement of activities will be presented in at least the same level of detail provided in the governmental fund statements—generally, expenses and program

revenues by function (for example, public safety), although governments are encouraged to provide more detailed information where relevant (for example, fire protection). Program expenses will include all direct expenses; governments that allocate overhead and other indirect expenses to individual programs will show the allocation in a separate column.

- *Special* and *extraordinary* items will be reported separately from other revenues and expenses. This way, users will see if the government’s conventional, recurring revenues and expenses balanced.
  - Special items are significant transactions or other events *within the control of management* that are either *unusual or infrequent in occurrence*, such as the proceeds from a sale of parkland.
  - Extraordinary items, by contrast, are beyond government’s control and are *both unusual and infrequent*, such as the cost of cleaning up a natural disaster.

## Retaining and Improving the Familiar

The annual reports prepared until now divided financial information among a variety of categories or “funds.” These funds are established by governing bodies (such as state legislatures or city councils) to show restrictions on the use of resources or to measure, *in the short term*, the revenues and expenditures arising from particular activities. Because the users of financial statements continue to assess government accountability by determining a government’s compliance with finance-related laws,

### Types of Funds

The various funds used by governments fall into three broad categories—*governmental, proprietary, and fiduciary*. Each category encompasses several types of funds:

**Governmental funds** track the basic activities of government:

- The *general fund* accounts for those resources not required to be in another fund.
- *Special revenue funds* track specific revenue sources that are restricted to a specific purpose.
- *Capital projects funds* follow the resources used to build and acquire major capital assets.
- *Debt service funds* account for resources used to repay long-term debt.
- *Permanent funds* report resources legally restricted so that only their earnings, and not their principal, may be used to finance operations.

**Proprietary funds** report activities generally financed and operated like private businesses:

- *Enterprise funds* account for activities for which a fee is charged to external users, such as an electric utility.
- *Internal service funds* report activities that provide goods or services to other funds, departments, or agencies of the government, such as a motor pool.

**Fiduciary funds** report assets that are held for others and that cannot be used to support the government’s own programs:

- *Pension (and other employee benefit) trust funds* account for resources held in trust for the members and beneficiaries of various employee benefit plans.
- *Investment trust funds* track the portion of the government’s investment pools that belongs to others.
- *Private-purpose trust funds* report all other trust arrangements benefiting those outside the government.
- *Agency funds* contain resources held by the government in a temporary, purely custodial capacity.

rules, and regulations, Statement 34 requires governments to continue to present financial statements with information about funds.

The focus of these fund-based statements has been sharpened, however, by requiring governments to report information about their most important or *major* funds, including a government's "general fund." Until now, fund information has been reported in the aggregate by type of fund, which obscures individual funds and thus often makes it difficult to assess a government's accountability for a significant individual program or a particular dedicated revenue.

Another important objective of annual reports should be to provide a comparison of the inflows of a government's resources with its outflows. Fund-based statements for governmental activities (generally, those supported by tax revenues) will continue to report the flow of *current financial resources* (generally, cash and other assets that can easily be converted to cash). These statements will still show the *short-term* performance of individual funds using the same measures that most governments use to manage their money (as opposed to the long-term focus of the full accrual-based government-wide statements).

#### Important features of the fund-based financial statements

- To help users understand and assess the relationship between fund-based and government-wide financial statements, governments will present a summary reconciliation that will show the interplay between the two types of statements.
- Each of the fund statements will report separate columns for the *general fund* and for other *major governmental and enterprise funds*. Major funds are those whose revenues, expenditures/expenses, assets, or liabilities are at least 10 percent of the total for their

fund category or type (governmental or enterprise) and at least 5 percent of the aggregate amount for all governmental *and* enterprise funds.

- Any other fund may be reported as a major fund if the government's officials believe the fund is particularly important to financial statement users.
- Nonmajor funds will be aggregated in a separate column.
- Internal service funds will also be aggregated in a separate column on the proprietary fund statements.
- Fund balances for governmental funds will be segregated into *reserved* and *unreserved* categories. Proprietary fund net assets will be reported in the same categories required for the government-wide statement of net assets. Proprietary fund balance sheets also will distinguish between *restricted* and *unrestricted* assets and *current* and *noncurrent* assets and liabilities.
- Proprietary fund statements of revenues, expenses, and changes in fund net assets will distinguish between *operating* and *nonoperating* revenues and expenses.
  - An all-inclusive *change in fund net assets* will include capital contributions, contributions to term and permanent endowments, special and extraordinary items, and transfers.
- Cash flows statements will be prepared using the *direct method*.
- Interfund loans, interfund services provided and used, interfund transfers, and other interfund activity will be reported separately in the fund-based financial statements and generally will be eliminated in the aggregated government-wide statements.

#### Budgetary comparison schedules

Demonstrating compliance with the adopted budget is an important component of a government's accountability to the public. Many citizens participate in one way or an-

#### Effective Date and Transition Provisions

The requirements of Statement 34 are effective in three phases based on a government's total annual revenues (based on the first fiscal year ending after June 15, 1999), as follows:

- Governments with total annual revenues of \$100 million or more will apply the Statement beginning with fiscal years ending after June 15, 2002.
- Governments with total annual revenues of \$10 million or more, but less than \$100 million, will apply the Statement beginning with fiscal years ending after June 15, 2003.
- Governments with total annual revenues below \$10 million will apply the Statement beginning with fiscal years ending after June 15, 2004.

In all cases, however, earlier implementation is encouraged.

Prospective reporting of newly acquired, constructed, or significantly renovated or improved infrastructure assets is required at the appropriate effective date of the Statement. Retroactive reporting of *existing* major general governmental infrastructure assets is encouraged at that date. However, governments will be allowed to report retroactively only major infrastructure assets acquired or significantly reconstructed or improved *during the previous 25 years*, and are allotted an *additional four years* beyond the effective date of the Statement to do so. Furthermore, governments with revenues under \$10 million are encouraged to report infrastructure assets retroactively, but may elect to report prospectively only.

other in the process of establishing the annual operating budgets of state and local governments, and have a keen interest in following the actual financial progress of their governments over the course of the year.

Governments will continue to provide budgetary comparison information in their annual reports. An important change, however, is a requirement to add the government's *original budget* to the current comparison of final budget and actual results. Many governments revise their original budgets over the course of the year for a variety of reasons. Requiring governments to report their original budget adds a new analytical dimension and increases the usefulness of the budgetary comparison. It will also allow users to assess the government's ability to estimate and manage its general resources.

### **About the GASB and This Project**

The Governmental Accounting Standards Board is a private, nonprofit body responsible for establishing and improving accounting and financial reporting standards for the more than 84,000 governmental units in the United States (not including the federal government). These include states, counties, cities, and other local governments, as well as any organizations under those governments' jurisdictions, such as public power authorities, municipal hospitals, and state universities. Governments are required to follow GASB standards in order to obtain clean opinions from their auditors. The GASB operates under the auspices of the nonprofit Financial Accounting Foundation. The Foundation oversees and funds the GASB and appoints its members, as well as the GASB's private-sector counterpart, the Financial Accounting Standards Board.

The new financial statement guidelines embodied in Statement 34 are the culmination of many years of study

and deliberation by the GASB, during which it established nearly three dozen new standards of governmental accounting and financial reporting that form the foundation of the new requirements.

In crafting the new guidelines, the GASB worked closely with the Governmental Accounting Standards Advisory Council, whose members are drawn from major organizations of financial statement users, auditors, and preparers. Highly placed state and local government officials from around the country are represented by members of the National Governors' Association, the U.S. Conference of Mayors, the National Conference of State Legislatures, the National Association of State Auditors, Comptrollers and Treasurers, the Government Finance Officers Association, and other professional groups. The financial community is represented by members of The Bond Market Association, the National Federation of Municipal Analysts, and the Association of Financial Guaranty Insurers, among others. Citizen watchdog groups, accounting associations, academics, and public power associations are represented by members of the Governmental Research Association, the American Institute of Certified Public Accountants, the American Accounting Association, the American Public Power Association, and others.

The GASB also benefited from the counsel of a special task force assembled specifically to advise with the preparation of the Statement. Like the Advisory Council, the task force's members were broadly drawn from the GASB's user, preparer, and auditor constituencies.

The extensive due process applied to the development of Statement 34 also involved reading and analyzing hundreds of comment letters, holding public hearings, and conducting approximately forty focus groups with financial statement users. The GASB is grateful for the input and assistance of the many people who shared their time and expertise to help craft the Statement.

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# Governmental Accounting Standards Board

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