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Historical development of the financial reporting model for state and local governments in the United States from late 1800s to 1999

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HISTORICAL DEVELOPMENT OF THE FINANCIAL REPORTING MODEL FOR STATE AND LOCAL GOVERNMENTS IN THE UNITED STATES FROM LATE 1800s TO 1999

Abstract: This study examines the historical development of the financial reporting model for state and local governments in the United States from the late 1800s through the issuance by the Governmental Accounting Standards Board (GASB) of *Statement No. 34* in 1999. This research shows how the current governmental reporting standard evolved over time to meet diverse user needs by presenting both government-wide and fund statements, and requiring three governmental operating statements with potentially three different measurement focuses: the Statement of Activities; the Statement of Revenues, Expenditures, and Changes in Fund Balances; and the Budgetary Comparison Schedule. Overall, this historical study provides unique insights about the development of the governmental reporting model and an appreciation for the reporting requirements of GASB *Statement No. 34*.

INTRODUCTION

The purpose of this study is to trace the historical development of the financial reporting model for state and local governments in the United States (U.S.), with an emphasis on governmental operating statements, from the late 1800s to the present by presenting issues and solutions over the years. In June 1999, the Governmental Accounting Standards Board (GASB, Board) issued *Statement No. 34; Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* [GASB, 1999] that presents the current state of the governmental reporting model. However, many of the concerns that were raised during the development of this model were not new and can be traced to issues discussed during the first half of the twentieth century: Should financial statements for state and local governments be consolidated or disaggregated? Should the measurement focus be the flows and balances of *current financial resources* or *economic resources*? Should financial statements prepared for external users emphasize the government's legally adopted budget? GASB *Statement No. 34* sought to resolve these issues.

Because many accountants are familiar with commercial accounting, the authors at the outset of this manuscript will provide a brief discussion of similarities and differences between the commercial and governmental financial reporting models in order for the reader to appreciate the development of the governmental model. Both models seek to provide timely financial data to their respective stakeholders for evaluation. This information is communicated primarily through the regular issuance of financial reports or statements. Also, both reporting models initially began by using a cash basis approach to financial reporting and then evolved to meet their respective stakeholder needs. Both models also present historical financial data in order to allow interpretation by stakeholders of their operating results.

The key differences between commercial and governmental financial reporting can be traced primarily to two issues: stakeholder needs and control. Commercial reporting has numerous stakeholders of the firm: directors, management, investors, creditors, regulators, unions, etc., while the primary stakeholders for governmental reporting are the citizenry, legislative and oversight bodies, investors and creditors, and government administrators [Freeman et al., 2011, pp. 17-18]. Stakeholders of business enterprises need financial reporting to be focused on financial performance—earnings and its components, while stakeholders of a government need governmental reporting to be focused primarily on accountability—acquiring financial resources and spending them in a legal and appropriate manner (GASB, 2006). Commercial reporting measures inflows and outflows of assets and takes a strategic, long-term approach to the presentation of historical data. In contrast, governments typically take a current operating approach for the display of fiscal information and focus on accountability, including comparisons to budgets. In the absence of supply and demand, and profit control devices inherent in profit-seeking entities, statutory, fund, and budgetary controls are used by governmental entities [Freeman et al., 2011, p. 24].

Previous academic studies have examined various aspects related to the development of governmental accounting by country: United Kingdom [Coombs and Edwards 1995; Perrin, 1998], India [Khumawala, 1997], and China [Aiken and Lu, 1993]. Other studies focused on historical development of governmental issues related to the United States: budgeting [Rubin, 1993] and standard-setting [Remis, 1982]. The current examination seeks to extend these accounting research studies by discussing the historical development of the governmental reporting model in the United States.

A limited number of academic studies address aspects pertaining to the development of the governmental reporting model. Thus, much of the archival material referenced in the early historical period of discussion in the present study is derived from textbooks that present a brief history on governmental accounting. In more recent years, the authors focus on academic articles that reveal more detail and insights, and support the underlying purpose of the present study. The authors acknowledge at the outset of this paper that the individuals and organizations cited do not represent all those that influenced the development of the governmental financial reporting model in the United States as it exists today, but the authors believe that the predominant ideas that led to its development are represented.

This study begins with a discussion of the early history (late 1800s to the 1970s) of the governmental reporting model. Then, the governmental reporting debate of the 1970s, the current financial reporting model—GASB *Statement No. 34*, and a conclusion are presented.

EARLY HISTORY

The beginnings of modern day financial accounting and governmental accounting in the United States can be traced to the late 1800s. Prior to this time, the majority of people in the United States lived on farms or in rural villages, but with the industrial revolution, cities began to grow at three times the rate of rural populations [Chatfield and Vangermeersch, 1996]. By the latter part of the nineteenth century, the growth in number and size of cities coupled with large-scale graft and corruption in some municipalities led to a demand for financial accountability [Cleveland, 1909]. The scope of this paper focuses only on governmental financial reporting models developed in the

United States beginning in the late 1800s.

The development of governmental financial reporting from the late 1800s until the 1970s can be traced through organizations and individuals that played significant roles. The National Municipal League (NML), founded in 1894, was a highly influential early reform agency [Fleischman and Marquette, 1987]. Harvey Chase led a group of certified public accountants that worked with the NML to obtain adoption of a uniform municipal accounting system [Chatfield and Vangermeersch, 1996]. The NML developed a number of standardized schedules for municipal reporting through its Committee on Uniform Municipal Accounting. Separate schedules were developed for revenue/expense accounts and asset/liability accounts [Fleischman and Marquette, 1987]. The U.S. Bureau of Census adopted the NML committee's general classification of expenditures and was also influential in the development of early accounting and reporting standards [Cleveland, 1909]. By the early 1900s, three states—Massachusetts, New York, and Ohio—had enacted legislation regarding uniform accounting and reporting, and several cities were publishing annual reports [Hebert, 1987].

Frederick Cleveland: Another type of group that was influential in the development of financial reporting for governments was the municipal research bureau. The first and most prominent was the New York Bureau of Municipal Research, which was founded in 1906. It was organized to tackle the financial problems of New York City, the largest city in the nation. Frederick Cleveland, a university professor and staff accountant for Haskins and Sells, became the director of the New York Bureau [Fleischman and Marquette, 1987].

The New York Bureau contributed to improved accountability among governments through publications of books and educational efforts that advocated the adoption of budgets and better accounting. In 1908, the New York Bureau first introduced the "budget exhibit." This exhibit, which was comprised of billboards and posters, provided a visual representation of how New York City was spending its money. Similar exhibits were held in 20 cities throughout the United States [Fleischman and Marquette, 1986].

In 1909, the New York Bureau published Cleveland's book, *Chapters on Municipal Administration and Accounting*, which detailed the problems of municipalities in the early 1900s and advocated that financial accountability be established [Cleveland, 1909].[1] To illustrate the problems in New York City in 1906, Cleveland recounts the concerns of Frank Vanderlip, the vice-president of City National Bank of New York. "Today, there is no true balance sheet. . . In none of the reports of the Controller is it possible to obtain in succinct form an intelligent view of the city's true financial position" [Cleveland, 1909, p. 124].

Cleveland [1909] argued for two balance sheets: a *current balance sheet* and a *capital balance sheet*. The *current balance sheet* would display the assets available for meeting current liabilities and current expenses. The *capital balance sheet* would represent the capitalized cost of permanent improvements and equipment along with the funds provided for such use.

Cleveland criticized the lack of true operating statements for most municipalities stating that the published reports of cities contained "little else than exhibits on the flow of cash" [Cleveland, 1909, p. 156]. He noted that the Bureau of Census, in its attempts to collect municipal finance data, could only obtain information on cash receipts and cash disbursements. In a 1904 paper presented to the Congress of Accountants in St. Louis, he noted that few municipal accounting officers saw the need for accounts of *expenses* and *revenues* and their record keeping [Cleveland, 1909, p. 156].

Based on Cleveland's comments, one can surmise that the earliest operating statements for municipalities were prepared with a focus on cash flows or a cash measurement focus.[2]

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[1] Frederick Cleveland was also greatly influential in developing responsible budgeting at the national level [Cleveland and Buck, 1920].

[2] Measurement focus describes the types of transactions and events that are measured and reported. A pure *cash* measurement focus reports only transactions and events that affect cash. A *current financial resources (or spending)* measurement focus reports transactions and events that affect an accounting entity's financial assets and related short-term liabilities. With this focus, *expenditures* (that is, financial resources expended) are measured. An expenditure is an outflow of financial resources (e.g., cash) for current operations (e.g., salaries, rent, or utilities), capital outlay (e.g., the purchase of a police car), or long-term debt principal retirement and interest. This measurement provides information about the sources and uses of available spendable resources during a period and information to assess whether sufficient resources existed to finance the current period's activities. An *economic resources* measurement focus reports transactions and events that affect all of an accounting entity's assets and liabilities (both current and long-term). With this focus, *expenses* are measured. Expenses are costs expired or the cost of goods or services used during a period. This measurement focus provides information to assess whether sufficient revenues were generated to cover the cost of providing services [Patton and Bean, 2001]. Commercial reporting uses accrual accounting and employs an *economic resources* measurement focus.

However, Cleveland [1909] advocated the use of an *economic resources* approach for operating statements of municipalities that would measure revenues and expenses. He reasoned [Cleveland, 1909, p. 162]:

> The purpose of assembling financial data of a municipal undertaking around two categories *expense* and *revenue* is to enable those interested in the public service to reach conclusions with respect to *economy* and efficiency *of administration*, and the relation of cost to provisions made for meeting it. . . A *detailed* and comprehensive *statement of expenses* is essential to a proper appreciation of cost to services rendered. A *comparative statement of expenses and revenues* serves two purposes of administrative economy: (1) Such an exhibit is necessary to determine whether adequate provision has been made to cover the costs of operations and maintenance in the past; and (2) a comparative statement of past expenses and revenues is the only safe guide to budgetary estimates and appropriations for the future.

Certainly, the definitions that Cleveland [1909] espoused for revenues and expenses are closely associated with those of the *economic resources* model. He clearly distinguished the difference between "cost" and "cash paid" by equating cost to expense and stating that an expense could be incurred during a period without a dollar being disbursed. He also supported the reporting of depreciation.

Metz Fund Handbook: Additional early support for fiscal accountability, including the use of a statement of revenues and expenses, can be attributed to Herman A. Metz. Metz, a New York businessman, was elected and served as comptroller of the City of New York from 1905 to 1909 [Davidson et al., 1977]. After leaving office and returning to business, Metz made substantial contributions to the New York Bureau of Municipal Research to establish a fund that would make available the experiences of New York and other municipalities to other governments that desired to improve their financial practices and procedures [Bureau of Municipal Research, 1914]. In 1913, the Bureau published the *Handbook of Municipal Accounting*, which is commonly referred to as the *Metz Fund Handbook* [Davidson et al., 1977]. Lloyd Morey [1948] considered the publication of this book to be the most significant contribution to municipal accounting in the 1910s.

The first chapter of the *Metz Fund Handbook* was devoted to revenues and expenses. The authors remorsefully stated that not more than six cities in the nation recognized the difference between a statement of cash inflows and outflows and a statement of revenues and expenses. The presentation of a statement of cash inflows and outflows would be desirable to render an accounting of the treasurer's office. The statement of revenues and expenses, embracing all of the city's financial transactions, would be an accounting of the city's chief financial officer.

If given the choice of presenting only one statement, it is clear that the handbook's authors would have chosen a statement of revenues and expenses because it better met their primary objective for financial reporting, which was to measure costs. They argued that a statement of revenues and expenses should explain the changes in assets and liabilities for an accounting period and would consider all financial transactions whether based on cash or credit. They also reasoned that total costs or expenses are needed to determine and develop the efficiency of administration [Bureau of Municipal Research, 1914, pp. 5-6].

To be useful to city officials and citizens, the authors believed the statement of revenues and expenses should include: (1) the revenue the city accrued by its right to levy taxes and charges for privileges and services; (2) the operation and maintenance costs of the city; and (3) the excess of revenues over costs or costs over revenues. Not surprisingly, an accrual basis of accounting was advocated for recording revenues and expenses. The rationale being that the results of the "financial program" implemented by city management could not be evaluated without considering "revenue accrued" and "costs incurred."

Thus, both Cleveland and the authors of the *Metz Fund Handbook* in the early 1900s advocated an *economic resources* approach using the accrual basis to prepare a government's primary operating statement. They agreed the prevalent approach of simply reporting cash inflows and outflows was inadequate to evaluate a city's administration.

Francis Oakey: Davidson et al. [1977] believed the shift in governmental accounting and financial reporting away from the *economic resources* approach advocated by Cleveland, the authors of the *Metz Fund Handbook*, and others as the reporting model for governmental funds could largely be attributed to the efforts of Francis Oakey. Oakey wrote *Principles of Government Accounting and Reporting*, which was published in 1921 by The Institute for Government Research, a predecessor of the Brookings Institute. Due to the clout of the publishers, Davidson et al. [1977] argued that Oakey's book was given authoritative status for governmental accounting.

Like earlier writers, Oakey [1921] advocated the use of funds. To be able to assess whether an executive officer of a city had properly discharged his/her duties in accordance with legal requirements, Oakey believed that a separate operating statement should be prepared for each fund. However, he differed from earlier writers as to the proper measurement focus for governmental operating statements by favoring a *current financial resources* rather than an *economic resources* approach. He noted the current practice was for cities to record revenues and expenditures on a cash basis although some cities, such as Philadelphia, Cleveland, and Seattle, had applied commercial (accrual) accounting principles. Still, he was concerned that "commercial accounting" applied to governments was inadequate in certain important aspects [Oakey, 1921]. Cities financed their operations differently than business enterprises. They simply raised the money estimated to be required to meet total anticipated expenditures with no expectation of profits remaining. The money was obtained from a variety of sources: taxation, miscellaneous revenues, and borrowings. These resources were then applied to the ordinary operating expenditures of the government and capital outlays. Oakley argued for a statement that identified the sources and amounts of receipts along with the objects or purposes for outlays [1921, p. 186].

In critiquing the financial statements of Philadelphia, Cleveland, and Los Angeles, which were prepared using the commercial method, Oakey noted that capital receipts and capital outlays were omitted and the disposition of capital receipts during the year was not shown. Thus, he found that governmental reporting was limited in that it did not present a complete accounting for the disposition or application of the current and working resources of the government during the period reviewed. These defects are also the result of not separating fund resources and obligations from all fixed assets and liabilities [Oakey, 1921, pp. 195-196].

Thus, Oakey believed that governmental financial statements should not be prepared using commercial accounting principles because governments were concerned with whether sufficient financial resources existed to cover anticipated expenditures including capital items. As a part of this determination, fund surplus (or fund balance) should represent *current financial resources* available for expenditure, and therefore, should not include fixed assets and long-term liabilities [Oakey, 1921]. Fernald [1918] shared Oakey's sentiments about the dangers of capitalizing fixed assets stating, "It is a fact that many towns have been lulled into a false sense of security by showing a large surplus as a result of including town properties as assets in the balance sheet" [Fernald, 1918, p. 275].

Oakey (1921) believed a consolidated statement of expendable fund operations would be the best form of operating statement for governmental activities.[3] He noted several advantages to using a consolidated statement of expendable fund operations [Oakey, 1921, pp. 193-194]:

1. This form of statement shows all the operations of expendable funds, presenting all transactions which increase the resources of such funds as well as all transactions which reduce resources.
2. It is a complete statement of operations, including capital outlays as well as expenses of administration, operation, and maintenance.
3. The disposition of the total amount of revenues is shown, drawing a distinction between expenditures out of revenue on account of the expenses of administration, operation, and maintenance, and expenditures out of revenues for capital outlays.
4. The transactions of expendable funds that derive their resources from sources other than revenues are shown according to the main classes of such funds, i.e., assessment funds, loan funds, and miscellaneous.
5. The statement is condensed enough to permit presentation on a single page providing, in summary form, an exhibit of all operations and facilitating and encouraging examination of details.

An examination of these advantages again reveals that Oakey advocated a different reporting model than did Cleveland and the authors of the *Metz Fund Handbook*. He was concerned that statements account for the flow of *current financial resources* and report expenditures for capital outlays. However, Oakey was not alone in his views. Many others [e.g., MacInnes, 1906; Chapman, 1910; Morey, 1927] believed that governmental units

[3] By a consolidated statement, Oakey meant that all funds would be presented on one statement. However, his illustrative operating statement used a pancake format rather than the columnar format.

differed from commercial businesses, and expenditures for capital outlays should be reported when acquired while depreciation accounting was not appropriate.[4]

Lloyd Morey: Lloyd Morey, who was a professor, comptroller, and later president of the University of Illinois, stated in his popular 1927 textbook, *Introduction to Governmental Accounting,* that similarities between governmental and commercial accounting had been overstated and too little attention had been paid to their differences. In his opinion, the application of commercial accounting to government accounts would also be misleading with ludicrous results [Morey, 1927, p. v]. Morey identified the lack of a profit objective as a significant difference between the two.

Instead of profit and loss accounts, Morey advocated accounting for revenues, expenditures, and surplus. He believed the focus of governmental accounting should be the recording and reporting of *current financial resource* flows. He notes that revenues received within the period should be reported and that they must be realizable in cash and expendable [Morey, 1927, p. 55].

In summary, Morey [1927] did not believe depreciation needed to be recorded because governmental accounting should not focus on profit and loss or costs expired. The primary focus should be on cost—the amount expended to purchase or build a capital asset. Again, this reflects his attitude that governmental entities differed from commercial enterprises. Governmental entities needed to be concerned with the flow of *current financial resources*. The concern was not the matching of revenues and expenses, but rather, whether the governments had financial resources available to meet operating, capital outlay, and debt service requirements. This emphasis on the differences in commercial and governmental enterprises can be further demonstrated in Morey's discussion of funds and the budget.

Although he believed that both businesses and governments needed to produce information about their past operations and present condition that would provide guidance for future operations, governments had additional responsibilities. Their accounting systems should ". . . provide for *control* of the acts of public officers and . . .*furnish information to the public* concerning the financial operations and conditions of the government"

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[4] Because outlays for capital assets are reported as expenditures in operating statements when acquired, capital assets would not be reported on the balance sheet. Likewise, depreciation would not be reported.

[Morey, 1927, p. 2].

The use of funds was one method of exercising control. Morey [1927] pointed out that separating revenues and other resources into funds was a common practice and showed that resources were being used for their intended purpose [Morey, 1927, p. 11]. Within the funds, Morey advocated using budgets to provide control or effective limitations on public officers. Further, budgets would furnish information to the public's representatives concerning the financial operations of the government. Once approved, the budget would form the basis for the government's accounting for the year [Morey, 1927].

Morey envisioned separate financial reports being prepared for internal and external use. Internal reports for department heads would stress unexpended appropriations. Reports to legislative bodies should be periodically prepared (e.g., monthly or quarterly) to show the condition and operations of various funds. Externally issued public reports should include condensed summary statements, a consolidated balance sheet, statements of income or revenue, statements of expenditures, statements of the operation of special funds, a statement of funded indebtedness, and a statement of inventories of property and equipment [Morey, 1927].

A review of these statements shows that Morey advocated the use of budget numbers (i.e., appropriations) for internal reporting and supported a statement of income and a statement of expenditures for external reporting. Thus, Oakey and Morey both believed a statement of income and expenditures prepared with a *current financial resources* measurement focus would be appropriate for municipal financial reporting, yet disagreed as to the format of the financial statements. Their writings contributed to the formation of the National Committee on Municipal Accounting (NCMA) in 1934 [Potts, 1976; Hebert, 1987].

National Committee on Municipal Accounting: The NCMA was an ad-hoc committee of the Municipal Finance Officers' Association of the United States and Canada that formulated municipal accounting principles, developed standard classifications and terminology for municipal reports, and promulgated standards [NCMA, 1935a]. Hebert [1987] noted the establishment of the NCMA was viewed as an important step in developing and standardizing municipal accounting and reporting principles.

By 1935, the NCMA had published in preliminary documents its principles of municipal accounting, procedures for a municipal audit, a bibliography for municipal accounting, and a booklet of municipal accounting terminology [NCMA, 1935b]. An examination of some of the early works of the NCMA provides insight into the principles and standards that the NCMA were attempting to establish.

In the NCMA's book on municipal accounting terminology, terms were defined within the context of governmental accounting. Of particular interest is the NCMA's definition of expenditures and expenses [NCMA, 1936, p. 142]:

> EXPENDITURES. Amounts paid or incurred for all purposes, including expenses, provision for retirement of debt, and capital outlays. Synonymous with outlay. NOTE: If the accounts are kept on the cash basis (q.v.) the term covers only actual disbursements. If the accounts are kept on the accrual basis (q.v.) the term includes also charges incurred but not paid.
>
> EXPENSES. Expenditures for operation, maintenance, interest, and other current purposes from which no permanent or subsequently convertible value is derived.

From these definitions, the reader can surmise that the NCMA authors did not intend for expenses to be considered cost of services as would be defined with an *economic resources* measurement focus. Instead, expenses were defined for governmental accounting purposes as a subset of expenditures. Expenditures included expenses (i.e., outlays for current operations, maintenance, etc.), amounts paid or incurred for the retirement of debt, and capital outlays. Expenditures could be recorded using either the cash or accrual basis of accounting, although the NCMA stated its preference to use the accrual basis for the statements of expenditures [NCMA, 1936, p. 7].

For financial reporting purposes, the NCMA [1936] recommended preparing a separate balance sheet for each fund or group of related funds. A combined balance sheet in columnar or sectional form to exhibit the assets, liabilities, reserves, and surplus of each fund was desirable. To report the results of operations for General and Special Revenue Funds, the NCMA suggested the use of three statements. The *Statement of Revenues—Estimated and Actual* would compare estimated revenue with actual revenue and show any excess or deficiency of estimated revenue over actual revenue. The *Statement of Expenditures and Encumbrances Compared with Appropriations* began with appropriations, subtracted expenditures and encumbrances, leaving an unencumbered balance. A third statement, an *Analysis of Changes in Unappropriated Surplus*, would reflect the changes to unappropriated surplus from budget and actual transactions shown on the other two statements. The resulting end of period unappropriated surplus would be divided into two components: the amount available during the next twelve months and the amount unavailable during the next twelve months [NCMA, 1936]. The need to divide unappropriated surplus into available and unavailable portions was at least partially due to using the accrual basis when recording property tax revenues. Although property taxes receivable would be an asset, the portion of unappropriated surplus represented by property taxes receivable not collectible early in the coming fiscal year would not be available for expenditure.

The operating statements reveal the importance the committee placed on budgetary reporting. In addition to the budgetary detail on the *Statements of Revenues* and *Expenditures*, the *Analysis of Change in Unappropriated Surplus* (which summarized the results of operations during the period) reported estimated revenues and appropriations in addition to actual revenues and expenditures. A clue to the reason for this detailed reporting of budgetary amounts may be found in the NCMA's comments on the purpose of reports. They indicate that they are an orderly grouping of facts and estimates relating to the condition of the fund, serve as a check on the operation of the budget, and as a guide for administrative action [NCMA, 1936, p. 2].

The committee believed that annual audited financial statements had an important administrative function. Financial reports should demonstrate compliance with legal provisions and that finances were properly administered. Interestingly, the NCMA stated that the statistical section of the report could be of more value to outside users than the financial statements [NCMA, 1936, p. 2]. By these comments, one can see the committee considered municipal administrators as the primary users of financial statements. This focus on internal administrative uses for financial statements is also found in its focus on fund reporting.

In the 1941 revision of *Bulletin No. 6; Municipal Accounting Statements*, the NCMA reemphasized the importance of reporting by individual funds [NCMA, 1941]. With regard to the order of presenting statements in the annual report, the NCMA recommended showing the statements of the General Fund first, and the combined balance sheet and related subsidiary statements last. The NCMA believed that the individual fund statements were more important than the combined statements [NCMA, 1941, p. 18].

National Committee on Governmental Accounting: The Municipal Finance Officers' Association (MFOA) formed the National Committee on Governmental Accounting (NComGA) in 1948 to replace the NCMA, which had disbanded in 1941. The NComGA reviewed, revised, and consolidated the work of the NCMA when it issued *Bulletin No. 14; Municipal Accounting and Auditing* in 1951. This *Bulletin*, which was considered the authoritative source for governmental accounting until the late 1960s, noted that one of the purposes of financial statements was to show legal provisions were met and funds had a proper accounting. However, unlike previous publications of the NCMA, the NComGA also recognized in *Bulletin No. 14* that municipal accounting systems should not only show compliance with laws, but also consider financial condition and results of financial operations [NComGA, 1951; Hebert, 1987].

Overall, the NCMA and NComGA established the role of the MFOA as the standard-setter for governmental accounting and reporting in the U.S. during their tenure. These organizations also supported individual fund reporting, which maintained its prominence until the late 1960s. Further, they standardized the required reports by governments and focused on funds, budgets, and legal compliance; yet the debate as to the proper measurement focus for governments continued.

Critics of Governmental Accounting: Although welcomed, the slight shift of purpose in governmental accounting and reporting from an almost exclusive administrative control function (NCMA) to one that considered the financial condition of the entity (NComGA) did not appease the critics. Dylmer Hylton [1957], professor at Wake Forrest College, bemoaned the state of governmental financial reporting. He indicated that published governmental reports left a lot to be desired [Hylton, 1957, p. 51]. A primary reason for his criticism was that governmental financial reports were too complex. ". . . The taxpayer, the 'owner' of the governmental unit, cannot fathom the reports published by his employees" [Hylton, 1957, p. 51]. Hylton advocated a consolidation and simplification for governmental financial reports. Although he admitted the importance of maintaining funds for financial control purposes, he believed a consolidated statement that reported all revenues and expenses of the governmental entity in one column would provide the citizen with better information to evaluate governmental operations [Hylton, 1957].

Russell Taussig [1963], an associate professor of finance at the University of Hawaii, agreed with Hylton that a major shortcoming in the reporting of state and local governmental units was the lack of statements that reported the financial position and results of operations of the government as a whole. Taussig disagreed with the NComGA [1951, p. 141] statement that, "No financial statement or statistical table combining the revenues and expenditures, respectively, of all funds and arriving at the total fund expenditures for a particular fiscal period can be prepared." He believed the transactions between funds could and should be eliminated in preparing a combined statement of revenues and expenses for the entity as a whole. Both Hylton [1957] and Taussig [1963] believed governmental operating statements should measure the cost of services and be prepared using an *economic resources* measurement focus (and accrual basis). Although governments were not concerned about profits, Taussig viewed the measurement of revenues and expenses as essential in evaluating a government's efficiency.

Governmental Accounting, Auditing, and Financial Reporting: While not agreeing to the consolidation advocated by Hylton and Taussig, the NComGA for the first time recommended presenting combined statements that would display financial data for the whole government before individual fund data in its 1968 publication, *Government Accounting, Auditing, and Financial Reporting* (*GAAFR*) [1968]. The rationale for the change was to benefit report users who did not need information on individual funds, but only major aspects of financial condition and operations [NComGA, 1968]. Because the 1968 *GAAFR*, with certain modifications, was recognized as generally accepted accounting principles (GAAP) by the American Institute of Certified Public Accountants (AICPA) when it released its audit guide, *Audits of State and Local Governments,* in February 1974, this reordering of financial statements became the norm.

The NComGA [1968] recommended that four combined statements be issued: 1) a *Combined Balance Sheet* for all funds, 2) a *Combined Statement of Revenues* comparing estimated and actual revenues for the General and Special Revenue Funds, 3) a *Combined Statement of Expenditures* for the general government compared with authorizations for General and Special Revenue Funds, and 4) a *Combined Statement of Cash Receipts and Disbursements* for all funds.

These four statements emphasized a budgetary focus. The *Combined Statement of Revenues* and *Combined Statement of Expenditures* included budget as well as actual amounts for the fiscal period. The NComGA considered accounting's role in determining legal compliance as coextensive with the need to provide financial information to user groups [NComGA, 1968, p. 4]. However, the NComGA [1968, p. 5] later stated that "Since legal requirements control and must take precedence over accounting considerations, the committee believes that each governmental unit must . . . prepare financial statements which reflect compliance with legal requirements." In essence, the NComGA believed that reporting the results of financial operations was important, probably of equal importance to legal requirements, but financial reporting for governments had to be controlled by legal compliance. Considering that the membership of the NComGA was primarily from governmental backgrounds, this concern for legal compliance is understandable. However, critics of governmental financial reporting argued that the fixation on legal compliance complicated and hindered the usefulness of governmental financial reports.

During this time period, the financial statements for governments became standardized and reflected legal compliance. They also began to emphasize usefulness to readers of financial reports from outside of government by presenting and ordering the reports differently. However, the measurement focus issue had not been completely resolved.

GOVERNMENTAL ACCOUNTING AND REPORTING DEBATE OF THE 1970S

Like the arguments made by Hylton and Taussig for simplification and measuring cost of services, many of the criticisms of governmental accounting that surfaced in the 1970s are germane to the current discussion of changes in the governmental reporting model. Recurring themes in the 1970s debate over the direction of governmental accounting and financial reporting were the reporting format, the measurement focus, and the role of the budget.

Reporting Format: The governmental reporting format discussions centered on whether financial statements for state and local governments would be more understandable to users, particularly citizen groups, if they were more like the financial statements of commercial enterprises. Representative of those who believed that governmental financial reporting should mimic commercial reporting guidelines were the authors of the Coopers and Lybrand and University of Michigan (1976) study of 46 American cities, published in 1976.

FIGURE 1

Consolidated Statement of Revenues, Expenditures, and Changes in Fund Balances

Name of Governmental Unit
Combined Statement of Revenues, Expenditures, and Changes in Fund Balances--
All Governmental Fund Types and Expendable Trust Funds
For the Fiscal Year Ended December 31, 19X2

	Governmental Fund Types					Fiduciary Fund Type	Totals (Memorandum Only) Year Ended	
	General	Special Revenue	Debt Service	Capital Projects	Special Assessments	Expendable Trust	December 31, 19X2	December 31, 19X1
Revenues:								
Taxes	$ 881,300	$ 189,300	$ 79,177	-	-	-	$ 1,149,777	$ 1,137,900
Special Assessment levied	-	-	-	-	$ 240,000	-	240,000	250,400
Licenses and Permits	103,000	-	-	-	-	-	103,000	96,500
Intergovernmental revenues	186,500	831,100	41,500	$ 1,250,000	-	-	2,309,100	1,258,800
Charges for services	91,000	79,100	-	-	-	-	170,100	160,400
Fines and forfeits	33,200	-	-	-	-	-	33,200	26,300
Miscellaneous revenues	19,500	71,625	7,140	3,750	29,095	$ 200	131,310	111,500
Total Revenues	1,314,500	1,171,125	127,817	1,253,750	269,095	200	4,136,487	3,041,800
Expenditures:								
Current:								
General government	121,805	-	-	-	-	-	121,805	134,200
Public safety	258,395	480,000	-	-	-	-	738,395	671,300
Highways and streets	85,400	417,000	-	-	-	-	502,400	408,700
Sanitation	56,250	-	-	-	-	-	56,250	44,100
Health	44,500	-	-	-	-	-	44,500	36,600
Welfare	46,800	-	-	-	-	-	46,800	41,400
Culture and recreation	40,900	256,450	-	-	-	-	297,350	286,400
Education	509,150	-	-	-	-	2,420	511,570	512,000
Capital outlay	-	-	-	1,625,500	313,100	-	1,938,600	803,000
Debt service:								
Principal retirement	-	-	60,000	-	-	-	60,000	52,100
Interest and fiscal charges	-	-	40,420	-	28,000	-	68,420	50,000
Total Expenditures	1,163,200	1,153,450	100,420	1,625,500	341,100	2,420	4,386,090	3,039,800
Excess of Revenues over (under) Expenditures	151,300	17,675	27,397	(371,750)	(72,005)	(2,220)	(249,603)	2,000
Other Financing Sources (Uses):								
Proceeds of general obligation bonds	-	-	-	900,000	-	-	900,000	
Operating transfers in	-	-	-	64,500	10,000	2,530	77,030	89,120
Operating transfers out	(74,500)	-	-	-	-	-	(74,500)	(87,000)
Total Other Financing Sources (Uses)	(74,500)	-	-	64,500	10,000	2,530	2,530	2,120
Excess of Revenues and Other Sources over (under) Expenditures and Other Uses	76,800	17,675	27,397	592,750	(62,005)	310	652,927	4,120
Fund Balances--January 1	202,500	151,035	182,813	357,350	293,075	26,555	1,213,328	1,209,208
Fund Balances--December 31	$ 279,300.00	$ 168,710.00	$ 210,210.00	$ 950,100.00	$ 231,070.00	$ 26,865.00	$ 1,866,255.00	$ 1,213,328.00

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

[NCGA, 1979]

Reasons cited for the need to change governmental reporting to a commercial format could be categorized as follows. First, external users of governmental financial reports were primarily the general public and investors. These external users could more readily understand the already familiar commercial-type financial reports. Second, external users needed summarized financial information that could be found in a single set of integrated financial statements prepared for the government as a whole. They had neither the need nor desire for the details in governmental financial reports then being published. Critics argued that governmental financial reports placed too much emphasis on legal compliance and internal financial reporting. Finally, external users needed a measure of the cost of services rather than just an accounting of expenditures during a fiscal period [Coopers and Lybrand and University of Michigan, 1976; Davidson et al., 1977; Touche Ross, 1977].

Even among those calling for changes to governmental financial reports, differences in opinions existed regarding the reporting format—especially the level of aggregation or consolidation—that should be used. Some would have argued that the *Combined Statement of Revenues, Expenditures, and Changes in Fund Balances* was an aggregated statement reporting the transactions of the *whole* entity (see Figure 1). The fund or fund type data presented on the face of the statement accounts for the operating, capital, and debt service transactions for the whole government.

The American Accounting Association's Committee on Accounting Practice of Not-for-Profit Organizations [1971] recommended the preparation of consolidated statements of financial position and operations. By *consolidated* statements, they meant that interfund transactions would be removed. Thus, they proposed an operating statement much like the one in Figure 1, but with the elimination of transfers and other interfund transactions. Others, however, advocated the complete elimination of funds for reporting purposes. In a 1981 study by the AICPA State and Local Government Accounting Committee, a *Consolidated Statement of Financial Activity* was illustrated that closely resembles the current government-wide *Statement of Activities* that is required by GASB *Statement No. 34* (see Figure 2). The illustrated statement combined all governmental and proprietary funds and reported on the entity as a whole, with no separate fund reporting.

Harold Steinberg, then the partner-in-charge of government service practices at Peat, Marwick, Mitchell & Co., feared the complete elimination of reporting by funds would have a negative effect on governments' accounting systems. In a 1979 *Journal of Accountancy* article, he indicated that some people suggested that fund accounting is acceptable for recording transactions but not for reporting purposes. He questioned this suggestion and reasoned that these two elements were interrelated and separating them was not acceptable [Steinberg, 1979, p. 49]. Many in governmental accounting shared Steinberg's belief that governmental entities should include funds in their external financial reports.

Measurement Focus: Another major issue in the 1970s was the proper measurement focus for governmental fund financial reporting. Should the measurement focus be on *current financial*

FIGURE 2

Government-wide Statement of Activities

Sample City
Statement of Activities
For the Year Ended December 31, 2002

	Primary Government						Component Units
		Program Revenues		Net (Expense) Revenue			
Functions/Programs	Expenses	Charges for Services	Grants and Contributions	Governmental Activities	Business-Type Activities	Total	Net (Expense) Revenue
Primary government:							
General government	$ 9,571,410	$ 3,146,915	$ 843,617	$ (5,580,878)		$ (5,580,878)	
Public safety	34,844,749	1,198,855	1,369,993	(32,275,901)		(32,275,901)	
Public works	10,128,538	850,000	2,252,615	(7,025,923)		(7,025,923)	
Engineering services	1,299,645	704,793		(594,852)		(594,852)	
Health and sanitation	6,738,672	5,612,267	575,000	(551,405)		(551,405)	
Cemetery	735,866	212,496		(523,370)		(523,370)	
Culture and recreation	11,532,350	3,995,199	2,450,000	(5,087,151)		(5,087,151)	
Community development	2,919,389		2,580,000	(339,389)		(339,389)	
Interest on long-term debt	6,068,121			(6,068,121)		(6,068,121)	
Water	3,595,733	4,159,350	1,159,909		$ 1,723,526	1,723,526	
Sewer	4,912,853	7,170,533	486,010		2,743,690	2,743,690	
Parking facilities	2,796,283	1,344,087			(1,452,196)	(1,452,196)	
Total primary government	$ 95,143,609	$ 28,394,495	$ 11,717,144	(58,046,990)	3,015,020	(55,031,970)	
Component units:							
Landfill	$ 3,382,157	$ 3,857,858	$ 11,397				$ 487,098
Public school system	31,186,498	705,765	3,937,083				(26,543,650)
Total component units	$ 34,568,655	$ 4,563,623	$ 3,948,480				(26,056,552)
General revenues:							
Taxes							
Real estate				34,168,449		34,168,449	21,893,273
Other				13,308,487		13,308,487	
Grants and contributions not restricted to specific programs				1,457,820		1,457,820	6,461,708
Interest and investment earnings				1,958,144	601,349	2,559,493	881,763
Miscellaneous				884,907	104,925	989,832	22,464
Total general revenues				51,777,807	706,274	52,484,081	29,259,208
Excess (deficiency) of revenues over expenses before special item				(6,269,183)	3,721,294	(2,547,889)	3,202,656
Special item:							
Gain on sale of park land				2,653,488		2,653,488	
Excess (deficiency) of revenues over expenses				(3,615,695)	3,721,294	105,599	3,202,656
Transfers				501,409	(501,409)		
Change in net assets				(3,114,286)	3,219,885	105,599	3,202,656
Net assets—beginning				126,673,160	82,349,309	209,022,469	16,025,971
Net assets—ending				$123,558,874	$ 85,569,194	$209,128,068	$ 19,228,627

[GASB, 1997, p. E-14].

resources or *economic resources*? Stated differently, should expenditures (i.e., decreases in financial resources for operations, capital outlay, and debt service) or expenses (i.e., costs of services or costs expired) be measured? Those who believed the measurement focus should be the flow of *current financial resources* argued that governments were different from commercial enterprises. The main concern of readers of governmental financial statements was whether the government had enough resources to maintain its current level of services. They also believed that reports should demonstrate that a government's management was complying with legal restrictions. Those who believed the measurement focus should be the flow of *economic resources* argued that governments were essentially the same as commercial enterprises. They noted that many commercial enterprises were required to file reports that were not prepared using commercial GAAP, but this did not prevent them from issuing financial statements based on the flow of *economic resources*. They argued that readers, particularly citizens, desired to judge the efficiency of government and that operating statements that reported expenses would provide information about the cost of services that could be used to measure efficiency [Davidson et al., 1977; Steinberg, 1979].

Steinberg [1979] summarizes this debate by focusing on objectives. For a corporation, the objective is to earn a profit and provide a return on investment, while governments seek to show what resources have been available to the governmental unit and how they were used. However, he stresses that costs are also important as they are a recognition of the liability incurred as a result of not obtaining enough resources to equal the cost of services provided. [Steinberg, 1979, p. 50].

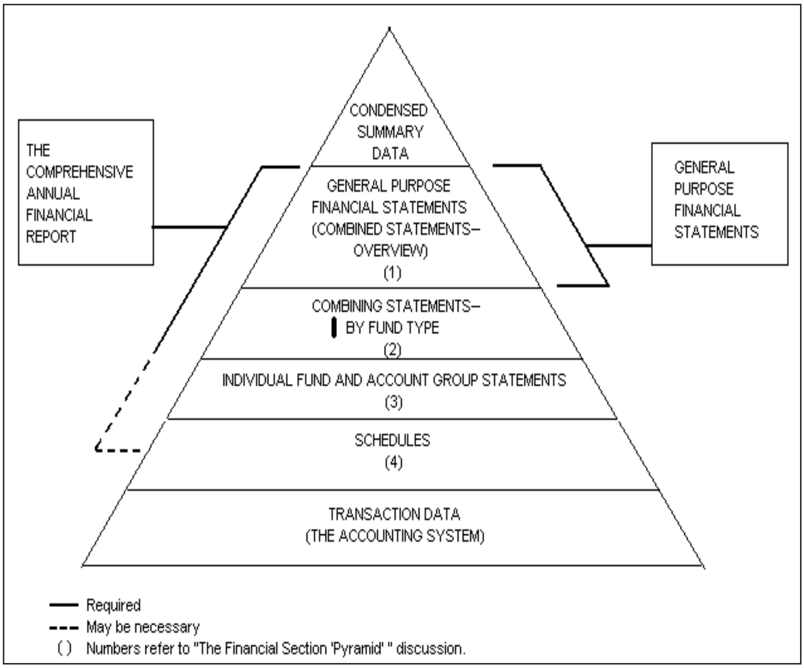
From this discussion of different purposes for governmental financial reporting, one is left to wonder how one set of financial statements could ever satisfy everyone. Steinberg [1979] pointed to a possible compromise. He suggested that governments use both measurement bases, not one to the exclusion of the other, and a reporting format that integrates and reflects the results of both [Steinberg, 1979, p. 50].

Role of the Budget: Again, in the 1970s much debate centered on which budget and actual comparison schedules should be included in a governmental financial report. Some [Coopers and Lybrand and University of Michigan, 1976; Anthony, 1978] believed that the budget was not very useful for external reporting purposes. They argued the budget was useful only for internal management purposes and should not be reported any more than the internal budgets of a commercial business. Others [Drebin, 1979; Steinberg, 1979] argued that the uniqueness of government, as distinguished from business, made external budgetary reporting important. Drebin expressed his view on the importance of budgetary reporting by saying that the public has an interest in knowing how resources were actually used in comparison to their planned allocation [Drebin, 1979, pp. 7-8].

Steinberg [1979] agreed that budgets should be included in financial reports to demonstrate government's compliance with the law. He believed that comparing actual results to the budget provided a means of assessing accountability and managerial performance. The view that actual results should be compared to the budget prevailed.

FIGURE 3

Financial Reporting Pyramid



[NCGA, 1979, p. 20].

National Council of Governmental Accounting: Further efforts to refine the governmental reporting model can be traced to the work of the MFOA's National Council of Governmental Accounting (NCGA), which succeeded the MFOA's NComGA in June 1974, and became the standard-setter for state and local government's GAAP prior to 1984 [Freeman, 1976]. In March 1979, the NCGA issued Statement 1, *Governmental Accounting and Financial Reporting Principles*, which was a restatement of the 1968 *GAAFR* issued by the NComGA [NCGA, 1980]. This statement defined the measurement focus and basis of accounting for governmental and proprietary funds. The statement also introduced the governmental financial reporting pyramid, which defines the reports that must be issued by a government as a part of a Comprehensive Annual Financial Report (CAFR) (see Figure 3).[5] A review of some of the provisions of NCGA *Statement 1* should help explain the present status of governmental financial reporting.

In NCGA *Statement 1*, the NCGA classified fund types into three categories: governmental, proprietary, and fiduciary. Governmental fund types included the General, Special Revenue, Debt Service, and Capital Projects Funds. Governmental fund types were "expendable" and had a "spending" (or *current financial resources*) measurement focus that emphasized "financial flow" operating data—the sources and uses of "available spendable resources" during a period. With a "spending" measurement focus, *expenditures* (i.e., financial resources expended) were measured. The modified accrual basis of accounting was used to determine when to recognize a transaction. Proprietary fund types were the Enterprise and Internal Service Funds. These "nonexpendable" funds had a "capital maintenance" (or *economic resources*) measurement focus and reported *expenses* in their operating statements. Operating statements for proprietary funds were prepared using the accrual basis of accounting. The third category of fund types, Trust and Agency Funds, were accounted for essentially like either the governmental or proprietary funds dependent upon their measurement focus. That is, Expendable Trust and Agency Funds with a "spending" measurement focus would have expenditures recognized using the modified accrual basis of accounting. Nonexpendable and Pension Trust Funds with a "capital maintenance" measurement focus would have expenses recognized using the accrual basis of accounting [NCGA, 1980].

The NCGA introduced the Financial Reporting Pyramid to illustrate the financial section of the CAFR. The CAFR should include General Purpose Financial Statements (GPFS) by fund type and account group (i.e., combined statements), combining statements by fund type, individual fund statements, and schedules. GPFS were an answer to critics of the 1968 *GAAFR* who complained that the focus on individual fund statements did not permit the wide distribution of sufficiently condensed financial statements. The GPFS required to be presented, if applicable, by

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[5] Soon after the GASB was formed, it recognized NCGA *Statement 1* as authoritative in GASB *Statement No. 1; Authoritative Status of NCGA Pronouncements and AICPA Industry Audit Guide* [GASB, 1984].

a government included [NCGA, 1980, p. 19]:

1. *Combined Balance Sheet—All Fund Types and Account Groups*,
2. *Combined Statement of Revenues, Expenditures, and Changes in Fund Balances—All Governmental and Expendable Trust Fund Types*,
3. *Combined Statement of Revenues, Expenditures, and Changes in Fund Balances—Budget and Actual—General and Special Revenue Fund Types* (and similar governmental fund types for which annual budgets have been legally adopted),
4. *Combined Statement of Revenues, Expenses, and Changes in Retained Earnings (or Equity)—All Proprietary and Nonexpendable and Pension Trust Fund Types*,
5. *Combined Statement of Changes in Financial Position—All Proprietary Fund Types*, and
6. Notes to the financial statements.

Considering the NCGA's efforts in improving the governmental financial reporting model and requirements, its contribution to modern day governmental accounting can hardly be questioned. However, the NCGA did not provide a satisfactory answer to the critics who believed governmental reporting would be more understandable and useful if it followed commercial accounting principles and reporting guidelines. Thus, the debate regarding measurement focus for governmental financial reports continued.

THE GOVERNMENTAL FINANCIAL REPORTING MODEL—GASB *STATEMENT NO. 34*

In an effort to provide more independence and due process to governmental standard-setting, plus resources, the Government Finance Officers Association (GFOA) (the successor to the MFOA) and its NCGA; the National Association of State Auditors, Comptrollers, and Treasurers (NASACT); and others ceded to the Governmental Accounting Standards Board (GASB), created by the Financial Accounting Foundation (FAF) in 1984, the standard-setting authority for state and local governments. The GASB would be in a "brother-sister" relationship with the other FAF organization, the FASB, and derive efficiencies and synergies from this organizational structure.

The long history of the GASB's Financial Reporting Model Project, one of the GASB's original agenda projects in 1984, is testimony to the difficulty of dealing with its many issues. Initially, the reporting model project encompassed issues such as determining the nature and extent of aggregation and consolidation, the display of budget versus actual information, and the organization and content of the financial statements. The project was expanded to include other issues and portions of other projects after 1984, such as determining the proper measurement focus and basis of accounting for governmental funds [GASB, 1995].

Overview of Statement No. 34 Requirements: In June 1999, the GASB issued GASB *Statement No. 34* (*Statement 34*), which requires governments to present a Management's Discussion and Analysis, basic financial statements, and certain other additional required supplementary information (RSI) as the minimum external reporting requirements for state and local governments. Basic financial statements include government-wide statements and fund financial statements [GASB, 1999].

The government-wide statements report financial information at a more aggregated level than the fund statements. These include a *Statement of Net Assets* and a *Statement of Activities*. The primary government's financial information (with separate columns for governmental and business-type activities) is reported separately from discretely presented component unit information. These statements are prepared using the *economic resources* measurement focus and accrual basis of accounting [GASB, 1999].

Fund financial statements report financial information at a more detailed level than do the government-wide statements and are presented after the government-wide statements. Separate fund financial statements are prepared for governmental, proprietary, and fiduciary funds. The measurement focus, basis of accounting, and required financial statements *vary* based on fund type being reported. Governmental funds are presented using the *current financial resources* measurement focus and the modified accrual basis of accounting. Financial statements required for governmental funds include a *Balance Sheet*; a *Statement of Revenues, Expenditures, and Changes in Fund Balances*; and a *Budgetary Comparison Schedule* (or *Statement*). Proprietary funds are presented using an *economic resources* measurement focus and accrual basis of accounting. Financial statements required for proprietary funds include a *Statement of Net Assets*; a *Statement* *of Revenues, Expenses, and Changes in Fund Net Assets*; and a *Statement of Cash Flows* [GASB, 1999]. (Because fiduciary activities do not benefit a government's program (but rather benefits those outside the government), the GASB excludes the reporting of fiduciary activities in the government-wide financial statements and reports them simply in the fiduciary fund financial statements [Ives, Patton, and Patton, 2013]).

Three Operating Statements for Activities Reported in Governmental Funds: *Statement 34* requires three types of operating statements for activities reported in governmental funds—using potentially three measurement focuses. The government-wide *Statement of Activities* (see Figure 2) is prepared using an *economic resources* measurement focus and accrual basis of accounting. This statement measures the net (expense) revenue of governmental activities, including depreciation expense of related capital assets [GASB, 1999].

FIGURE 4

Statement of Revenues, Expeditures, and Changes in Fund Balances

	General Fund	HUD Programs	Community Redevelopment	Route 7 Construction Fund	Other Governmental Funds	Total Governmental Funds
REVENUES						
Property taxes	$ 51,173,436	$ —	$ —	$ —	$ 4,680,192	$ 55,853,628
Franchise taxes	4,055,505	—	—	—	—	4,055,505
Public service taxes	8,969,887	—	—	—	—	8,969,887
Fees and fines	606,946	—	—	—	—	606,946
Licenses and permits	2,287,794	—	—	—	—	2,287,794
Intergovernmental	6,119,938	2,578,191	—	—	2,830,916	11,529,045
Charges for services	11,374,460	—	—	—	30,708	11,405,168
Investment earnings	552,325	87,106	549,489	270,161	364,330	1,823,411
Miscellaneous	881,874	66,176	—	2,939	94	951,083
Total revenues	86,022,165	2,731,473	549,489	273,100	7,906,240	97,482,467
EXPENDITURES						
Current:						
General government	8,630,835	—	417,814	16,700	121,052	9,186,401
Public safety	33,729,623	—	—	—	—	33,729,623
Public works	4,975,775	—	—	—	3,721,542	8,697,317
Engineering services	1,299,645	—	—	—	—	1,299,645
Health and sanitation	6,070,032	—	—	—	—	6,070,032
Cemetery	706,305	—	—	—	—	706,305
Culture and recreation	11,411,685	—	—	—	—	11,411,685
Community development	—	2,954,389	—	—	—	2,954,389
Education—payment to school district	21,893,273	—	—	—	—	21,893,273
Debt service:						
Principal	—	—	—	—	3,450,000	3,450,000
Interest and other charges	—	—	470,440	—	5,215,151	5,685,591
Capital outlay	—	—	2,246,671	11,281,769	3,190,209	16,718,649
Total expenditures	88,717,173	2,954,389	3,134,925	11,298,469	15,697,954	121,802,910
Excess (deficiency) of revenues over expenditures	(2,695,008)	(222,916)	(2,585,436)	(11,025,369)	(7,791,714)	(24,320,443)
OTHER FINANCING SOURCES (USES)						
Refunding bonds issued	—	—	—	—	38,045,000	38,045,000
Capital-related debt issued	—	—	18,000,000	—	1,300,000	19,300,000
Payment to bond refunding escrow agent	—	—	—	—	(37,284,144)	(37,284,144)
Transfers in	129,323	—	—	—	5,551,187	5,680,510
Transfers out	(2,163,759)	(348,046)	(2,273,187)	—	(219,076)	(5,004,068)
Total other financing sources and uses	(2,034,436)	(348,046)	15,726,813	—	7,392,967	20,737,298
SPECIAL ITEM						
Proceeds from sale of park land	3,476,488	—	—	—	—	3,476,488
Net change in fund balances (See Exhibit 5)	(1,252,956)	(570,962)	13,141,377	(11,025,369)	(398,747)	(106,657)
Fund balances—beginning	2,908,322	1,647,338	34,110	20,387,774	10,022,219	34,999,763
Fund balances—ending	$ 1,655,366	$ 1,076,376	$ 13,175,487	$ 9,362,405	$ 9,623,472	$ 34,893,106

[GASB, 2000, p. 126].

The second operating statement is a fund financial statement—the *Statement of Revenues, Expenditures, and Changes in Fund Balances* (see Figure 4). It reports the inflows, outflows, and balances of *current financial resources* for a government's general fund, major special revenue funds, and other governmental funds in the aggregate. This statement uses the *current financial resources* measurement focus and modified accrual basis of accounting and is similar to the operating statement required under the pre-*Statement 34* reporting model except for two substantive modifications. One modification is that a reconciliation of the fund statements to the government-wide statements must be included at the bottom of the fund statement or in a schedule [GASB, 1999]. Another significant modification to the pre-*Statement 34* model was changing the focus of fund-based reporting from *fund types* to *major funds*. Reporting major funds in the fund financial statements provides much more detail about those funds than would occur when only reporting by fund type. However, non-major funds that do not meet the criteria established by the GASB for major funds are required to be reported in one column in the *Statement of Revenues, Expenditures, and Changes in Fund Balances*. This may result in less information about non-major funds than if they had been reported by fund type [GASB, 1999].

The third operating statement is the *Budgetary Comparison Statement* (or *Schedule*) (see Figure 5). Budgetary comparisons are required for the General Fund and major Special Revenue Funds with a legally adopted annual budget. The statement (schedule) reports the original and final appropriated budgets and the actual results for the period using the government's budgetary basis of accounting. Governments may present a *Budgetary Comparison Statement* rather than a *Budgetary Comparison Schedule* [GASB, 1999]. The main differences between the statement and schedule are the placement of the budgetary information within the financial report and the audit requirements for the information. Budgetary Comparison Statements are a part of a government's basic financial statements and auditors report on the fairness of their presentation. Budgetary Comparison Schedules are a part of RSI, reported after the notes to the basic financial statements, and auditors do not express an opinion on the fairness of their presentation.

Accountability: Two of the critical issues that the GASB faced in developing the current reporting model were whether financial statements should be aggregated or disaggregated and the

FIGURE 5

Budgetary Comparison Statement

Sample City
Budgetary Comparison Statement
General Fund
For the Year Ended December 31, 2002

	Budgeted Amounts Original	Budgeted Amounts Final	Actual Amounts (Budgetary Basis)	Variance with Final Budget Positive (Negative)
Budgetary fund balance, January 1	$ 2,736,824	$ 1,950,873	$ 1,950,873	
Resources (inflows)				
Property taxes	30,124,560	29,959,745	29,280,163	$ (679,582)
Franchise taxes	4,546,209	4,528,750	4,055,505	(473,245)
Public service taxes	8,295,000	8,307,274	8,969,887	662,613
Licenses and permits	2,126,600	2,126,600	2,287,794	161,194
Fines and forfeitures	718,800	718,800	606,946	(111,854)
Charges for services	12,392,972	11,202,150	11,374,460	172,310
Grants	6,905,898	6,571,360	6,119,938	(451,422)
Sale of land	1,355,250	3,500,000	3,476,488	(23,512)
Miscellaneous	3,024,292	1,220,991	881,874	(339,117)
Interest received	1,015,945	550,000	552,325	2,325
Transfers from other funds	939,525	130,000	129,323	(677)
Amounts available for appropriation	74,181,875	70,766,543	69,685,576	(1,080,967)
Charges to appropriations (outflows)				
General government:				
Legal	665,275	663,677	632,719	30,958
Mayor, legislative, fiduciary, and audit	3,058,750	3,192,910	2,658,264	534,646
Finance and accounting	1,932,500	1,912,702	1,852,687	60,015
City clerk and elections	345,860	354,237	341,206	13,031
Employee relations	1,315,500	1,300,498	1,234,232	66,266
Planning and economic development	1,975,600	1,784,314	1,642,575	141,739
Public safety:				
Police	19,576,820	20,367,917	20,246,496	121,421
Fire department	9,565,280	9,358,453	9,559,967	(201,514)
EMS	2,323,171	2,470,127	2,459,866	10,261
Inspections	1,585,695	1,585,695	1,533,380	52,315
Public works:				
Public works administration	388,500	385,013	383,397	1,616
Street maintenance	2,152,750	2,019,166	2,233,362	(214,196)
Street lighting	762,750	742,540	759,832	(17,292)
Traffic operations	385,945	374,945	360,509	14,436
Mechanical maintenance	1,525,685	1,272,696	1,256,087	16,609
Engineering services:				
Engineering administration	1,170,650	1,140,289	1,158,023	(17,734)
Geographical information system	125,625	119,315	138,967	(19,652)
Health and sanitation:				
Garbage pickup	5,756,250	5,865,757	6,174,653	(308,896)
Cemetery:				
Personal services	425,000	425,000	422,562	2,438
Purchases of goods and services	299,500	299,500	283,743	15,757
Culture and recreation:				
Library	985,230	1,023,465	1,022,167	1,298
Parks and recreation	9,521,560	9,786,397	9,756,618	29,779
Community communications	552,350	558,208	510,361	47,847
Nondepartmental:				
Miscellaneous			259,817	(259,817)
Contingency	2,544,049			
Transfers to other funds	2,970,256	2,025,000	2,163,759	(138,759)
Total charges to appropriations	71,910,551	69,027,821	69,045,249	(17,428)
Budgetary fund balance, December 31	$ 2,271,324	$ 1,738,722	$ 640,327	$ (1,098,395)

[GASB, 1997, p. E-21].

choice of a measurement focus for governmental fund financial statements. These issues had been discussed and debated for much of the century and were discussed by the GASB during much of its fifteen year existence. The Board's decision to require both aggregated (government-wide) and disaggregated (fund) financial statements in *Statement 34* and its related decision to continue using a *current financial resources* measurement focus for governmental funds was largely based on the Board's view of accountability.

In Concepts Statement No. 1, the GASB discussed financial reporting objectives for governmental entities. Accountability was identified to be the primary objective for financial reporting [GASB, 1987, paragraph 56]. This concept of accountability broadened the traditional definition of accountability, which had emphasized *fiscal accountability*—that is, "the responsibility of governments to justify that their actions in the current period have complied with public decisions concerning the raising and spending of public moneys in the short-term (usually one budget cycle or year)"—to also consider the need to report governmental activities based on the concept of *operational accountability* [GASB, 1999, paragraph 203].[6] "Operational accountability is governments' responsibility to report the extent to which they have met their operating objectives efficiently and effectively, using all resources available for that purpose, and whether they can continue to meet their objectives for the foreseeable future" [GASB, 1999, paragraph 203].

Incorporating a dual view of accountability (i.e., fiscal and operational) into a single set of financial statements proved difficult and was a major factor in the GASB's requiring both government-wide and fund financial statements. Operational accountability for the government as a whole is addressed in the government-wide *Statement of Net Assets* and *Statement of Activities* that utilize an *economic resources* measurement focus [GASB, 1999]. Fund financial statements (*Balance Sheet* and *Statement of Revenues, Expenditures, and Changes in Fund Balances*) are included to report on fiscal accountability (using the *current financial resources* measurement focus) for governmental funds of the primary government. The GASB [1999, paragraph 213] notes that requiring both types of statements allows users to assess the government's cost of services for both governmental and business-type activities, while retaining the fiscal accountability information users have found useful.

Budgetary Comparisons: The Board reaffirmed the importance of reporting budget and actual comparisons in *Statement 34* by requiring that either *Budgetary Comparison Schedules* (or *Statements*) be included for a government's General and major Special Revenue funds. The Board's reasons for including budgetary comparison information are similar to those expressed by Drebin [1979] and Steinburg [1979]. The Board agreed that budgetary reporting does provide important information about a government's compliance with the legally adopted budget. Although some respondents to the GASB's Exposure Draft for

[6] Fiscal accountability emphasizes the short-term flow of financial resources (or the flow of *current financial resources*), and thus, is necessarily linked to the *current financial resources* measurement focus.

Statement 34 argued that such information should only be disclosed in the notes when governments were not in compliance with budget, the Board decided that the best and most concise way to present this information was to present budgetary comparison schedules or statements [GASB, 1999].

The compelling reason for the Board requiring the presentation of budgetary comparisons, however, was not the argument that it was necessary to demonstrate compliance. The compelling reason was that budgetary comparisons provide the information necessary to assess whether resources were obtained and used in accordance with a government's legally adopted budget. This is consistent with one of the objectives of financial reporting found in Concepts Statement 1 [GASB, 1999].

Although the Board continued to acknowledge the importance of reporting budgetary comparisons, it did not believe that such comparisons were essential to a user's understanding of a government's financial position and results of operations. Therefore, the GASB encouraged governments to present budget comparisons as RSI (behind the notes to the financial statements) instead of as a basic financial statement.

CONCLUSION

This study traced the development of governmental accounting and financial reporting in the United States, particularly as it relates to the governmental operating statements, from their development in the late 1800s to 1999. Through the years, much has changed, but much has also remained the same. Beginning in the late 1800s, the need for government accountability over financial resources became apparent. This began with exercising control over cash and reporting on cash flows, assets, and liabilities. Through the years, accountants disagreed about how much governmental financial reporting should be like commercial reporting.

This paper focused on several issues related to the proper reporting of governmental activities that have been debated over the years: the level of aggregation for governmental financial statements, the appropriate measurement focus, and the display of budgetary information. The GASB worked to provide an answer for these questions for 15 years and ultimately determined that no one answer was correct.

With the issuance of Statement No. 34 in June 1999, the GASB acknowledged that two types of accountability were important for financial reporting. Fiscal accountability, which has a short-term emphasis, uses a *current financial resources* measurement focus. This has been the measurement focus for governmental funds since the days of Oakey and Morey. The GASB reaffirmed that *current financial resources* was the appropriate measurement focus for activities accounted for in governmental funds when it issued Statement No. 34.

However, the GASB also acknowledged the importance of operational accountability in reporting governmental activities. Therefore, the GASB requires governmental activities to be reported in government-wide financial statements using the *economic resources* measurement focus, which conceptually had been advocated by Cleveland, Metz, Hylton, and Taussig.

Beginning in the late 1950s, Hylton and Taussig were advocates for preparing consolidated financial statements for state and local governments. In 1971, the American Accounting Association's Committee on Accounting Practice of Not-for-Profit Organizations recommended a form of consolidated financial statements be prepared. Based on a 1976 study by Coopers and Lybrand and University of Michigan, their researchers recommended a single set of integrated financial statements be prepared for a government as a whole.

With the issuance of *Statement No. 34* in June 1999, the GASB required both fund financial and government-wide statements. Ultimately, the GASB's decision was consistent with the approach Steinberg had discussed in 1979. That is, governmental activities could be reported using both the *current financial resources* measurement focus and the *economic resources* measurement focus, but in different reporting formats.

Finally, the GASB reaffirmed the importance of budgetary reporting when Statement No. 34 required either Budgetary Comparison Statements (or Schedules) be prepared for the General and major Special Revenue funds. The amounts reported on the budgetary comparison schedules (or statements) are based on the measurement focus and the basis of accounting used by the government to budget. Overall, an examination of the historical development of the financial reporting model for state and local governments provides unique insights and an appreciation for the development and importance of GASB *Statement No. 34* [1999].

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