



Governmental Accounting Standards Board
of the Financial Accounting Foundation

August 2006

Building a Better Conceptual Foundation

Earlier this month the Governmental Accounting Standards Board (GASB) proposed its fourth concepts statement. The proposal, referred to as an Exposure Draft (ED), is titled *Elements of Financial Statements*. The ED can be downloaded free from the GASB's Web site (www.gasb.org/exp). The GASB invites comments and has set a deadline of November 17.

Unlike GASB pronouncements, Concepts Statements do not establish accounting and financial reporting standards. Rather than the preparers and auditors of financial statements, the primary audience for a final Concepts Statement is the GASB itself. Concepts Statements provide a framework for setting standards, guiding the GASB and helping it maintain a consistent conceptual approach from standard to standard. You might call them standards for the standards setters. This particular proposal lays out suggested definitions for the various items that appear in financial statements, such as assets and liabilities.

Some people believe that a proposed Concepts Statement should come complete with green eyeshades or be required to bear a label reading, "Warning: accounting enthusiasts only!" Truthfully, Concepts Statements do approach governmental accounting at a 30,000-foot level. But they also deal with accounting and financial reporting in a very fundamental way that has important implications. For example, when the GASB establishes standards in the future for reporting a particular obligation—such as the obligation of a government to clean up pollution on land it owns—the definition of a liability will strongly influence decisions about whether the obligation in question is a liability of a government and therefore whether it should be reported in the financial statements. In other words, these definitions will establish a line demarking in general what resources, obligations, and inflows and outflows of resources will make it into the financial statements and which will be excluded. Therefore, the definitions of financial statement elements will affect whether the users of financial statements will receive certain information or not.

What Does the Proposal Say?

Other standards-setters have developed definitions of the elements of financial statements as well, including the Financial Accounting Standards Board (FASB, the GASB's sister organization for private corporations and not-for-profit organizations) and the International Accounting Standards Board (IASB). The FASB and the IASB are currently working together to update and harmonize their conceptual frameworks. The

Federal Accounting Standards Advisory Board (the FASAB, which establishes accounting standards for the United States federal government) also is currently exposing proposed elements definitions. The GASB's proposal is a departure from other efforts in at least two important ways.

Independent Definitions. It is common to define financial statement elements based on the definition of a particular element or elements. For example, a revenue might commonly be defined as an inflow of or increase in assets or the settlement of a liability, and an expense might be viewed as an outflow or using up of assets or the incurring of a liability. To understand what revenues and expenses are, you first have to understand what assets and liabilities are. The GASB took a different path because it did not believe that any particular element is more important than another. The GASB developed definitions of the individual elements that were independent of each other (with the exception of net assets). To do so, the GASB began first by defining a concept that would central to the definitions—a *resource*.

The ED defines a resource as something with a *present capacity to provide services*. The elements definitions incorporate this notion of a resource:

- *Assets* are resources a government controls at present.
- *Liabilities* are present obligations to sacrifice resources or future resources that a government has little or no discretion to avoid.
- *Net assets* are the residual of all other elements presented in a statement of financial position.
- An *outflow of resources* is a consumption of net resources by a government that is applicable to the reporting period.
- An *inflow of resources* is an acquisition of net resources by a government that is applicable to the reporting period.

Assets, liabilities, and net assets are elements of statements of financial position, such as the government-wide statement of net assets. Outflows and inflows of resources are elements of resource flows statements, such as the governmental fund statement of revenues, expenditures, and changes in fund balance.

Separate Treatment of Deferrals. The ED also defines two other elements financial position statements:

- A *deferred outflow of resources* is a consumption of net resources by a government that is applicable to a future reporting period.
- A *deferred inflow of resources* is an acquisition of net resources by a government that is applicable to a future reporting period.

Deferrals generally have not been defined separately, leaving many to wonder just what they are and why they appear with the assets and liabilities when they do not directly bear the characteristics of either. For that reason, the GASB considered it important to define them as separate elements. Deferrals might be looked at as future revenues and expenses waiting to be recognized—perhaps until required conditions have been met or a particular point of time has been reached.

Why Didn't the GASB Just Adopt the Existing Definitions of Elements?

An essential difference between private companies and governments is that the latter do not exist to generate profit. Rather, governments exist to provide services to their constituents. The notion of the capacity to provide service is already embodied in standards such as GASB Statement 42 on the impairment of capital assets. Whereas private sector standards consider an asset impaired when it no longer can generate cash flows, the GASB's standards identify impairment as a loss of service capacity. Until now, this fundamental philosophy has not yet been officially expressed in the GASB's conceptual framework. By sharing the idea of a resource, the proposed definitions incorporate service capacity as an essential facet.

The GASB did benefit, however, from the work of other standards setters. The GASB closely considered the concepts of the FASB, IASB, FASAB, and others. Certain portions of the definitions are, in fact, quite similar.

How Can You Help the GASB Complete the Concepts Statement?

You can assist the GASB with the process of finalizing this Concepts Statement by reading the proposal and providing feedback. The ED poses questions about specific issues, but you are free to comment on any aspect of the proposal. It is most helpful if you react to not only the aspects you disagree with, but also those that you support. In addition, it is most valuable to the GASB when respondents explain why they support or oppose a particular facet of a proposal.

An Internet-based form is available for submitting your comments (<http://www.gasb.org/survey/cgi-bin/elements.html>). You can also submit comments by email (director@gasb.org) or by mail (sent to the address below). Email and mail submissions should be addressed to the Director of Research and Technical Activities, Project 3-11. The GASB also will be holding a public hearing at its Norwalk, CT, offices on November 30; you can attend in person or participate via telephone. Additional information about responding to the ED or participating in the public hearing can be found in the front of the ED.

Written comments should be submitted to:

Director of Research and Technical Activities
Project 3-11
Governmental Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116