

APPENDIX C

BRIEF HISTORY OF GOVERNMENTAL ACCOUNTING STANDARDS SETTING

Systematic governmental financial reporting in the United States traces its beginnings to the last decade of the nineteenth century and early part of the twentieth century. At that time, the growth in the number and size of cities, coupled with corruption in municipalities, led to a demand for financial accountability.⁷ Many of the features of modern-day governmental financial reporting can be seen in the *Handbook of Municipal Accounting* (1913) prepared by the Metz Fund and the writings of Francis Oakey, whose book *Principles of Government Accounting and Reporting* (1921) was considered authoritative, and Lloyd Morey, whose popular textbook, *Introduction to Governmental Accounting*, was published in 1927. Oakey and Morey were concerned that the then “commercial accounting” was not entirely adequate for governments.

Morey identified the lack of a profit motive as one important factor that would affect financial reporting for governments; there was no need for governments to report on profit and loss. Oakey stated that cities financed their operations through taxes, miscellaneous revenue, and borrowing for the purpose of raising sufficient amounts to meet total anticipated expenditures, including capital items. He believed financial reporting should show a government’s fund surplus (or balance) that represents the resources currently available for expenditure. Oakey and Morey advocated financial reporting using funds, which would allow readers to assess whether an executive officer of a city had properly discharged his or her duties in accordance with legal requirements. The writings of Oakey and Morey contributed to the formation of the National Committee on Municipal Accounting (NCMA) that began to promulgate standards in 1934.⁸

⁷Frederick A. Cleveland, *Chapters on Municipal Administration and Accounting* (New York: Longmans, Green and Co., 1909).

⁸James H. Potts, “An Analysis of the Evolution of Municipal Accounting to 1935 with Primary Emphasis on the Developments in the United States” (Ph.D. dissertation, University of Alabama, 1976). Marcel G. Hebert, “An Investigation of the Effect of Alternative Presentation Formats on Preparers and Users of City Financial Reports” (Ph.D. dissertation, Texas Tech University, 1987).

To ensure that governmental accounting issues received appropriate attention, the NCMA was formed as an ad-hoc committee of the Municipal Finance Officers Association (MFOA) of the United States and Canada. It and successor bodies formed under the MFOA formulated municipal accounting principles, developed standard classification and terminology for municipal reports, and promulgated standards that reflect the unique or distinguishing characteristics of government. The NCMA believed that reporting budgetary information compared to actual information in financial statements was important to demonstrate compliance with legal provisions and to show proper administration of finances. Therefore, they recommended that governments present statements that would compare estimated revenues with actual revenues, and appropriations with expenditures and encumbrances.

Through the efforts of the NCMA and the National Committee on Governmental Accounting (NCGA), a successor committee of the MFOA, including publication of the authoritative guidance in the 1968 “blue book” titled *Governmental Accounting, Auditing, and Financial Reporting*, governmental financial reporting evolved from reporting on individual funds to reporting combined and combining financial statements for governmental, proprietary, and fiduciary funds. Concomitant with changing the name of the NCGA to the National Council on Governmental Accounting, the NCGA was reorganized as a standards-setting body that followed due process procedures and continued to focus governmental fund financial reporting on the flow of current financial resources using the modified accrual basis of accounting.

Subsequently, critics of governmental financial reporting called for governments to report more like businesses. Criticisms were leveled at the differences between financial reporting by business enterprises and governments, citing lack of understandability because government financial statements used the modified accrual basis of accounting and reported a number of funds without consolidation. The recommendation was not that governments and business enterprises should report using the same set of accounting standards or that a single standards setter should be responsible for both types of organizations. Rather, the recommendation primarily was to bring the benefits of accrual accounting—full cost of services information and consolidated financial statements—to governments. Through issuance of many standards

including GASB Statement 34, the GASB has addressed these criticisms while not ignoring the distinctive characteristics of government that are a key part of its reporting objectives.

As already noted, the Financial Accounting Foundation established the Governmental Accounting Standards Board in 1984 as the independent standards setter for state and local governments. The decision to establish a separate standards board reflects the sovereign nature of state governments and their desire to have a standards setter that focused on the needs of the state and local financial statement users. State governments are not creations of the federal government. Rather, the federal government was created by the states upon ratification of the United States Constitution, with certain aspects of states' sovereign powers transferred to the federal government, and with all other powers retained by states. Establishment of accounting standards for themselves (and local governments, which were created by states) is a power retained by the states. Like Oakey, Morey, the NCMA, and the NCGA, the GASB recognizes the unique and distinguishing features of government and reflects them in its standards setting.