



# Exposure Draft

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June 17, 2020

Comments Due: February 26, 2021

Proposed Statement  
of the Governmental Accounting Standards Board  
on concepts related to

## **Recognition of Elements of Financial Statements**

This Exposure Draft of a proposed Statement of Governmental Accounting Concepts is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities  
Project No. 3-20

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Governmental Accounting Standards Board

# RECOGNITION OF ELEMENTS OF FINANCIAL STATEMENTS

## Notice of Public Hearings and User Forums, and Request for Written Comments

### PUBLIC HEARINGS AND USER FORUMS

#### **Public hearings are tentatively scheduled as follows:**

- March 23, 2021, in Boise, ID (in conjunction with the annual conference of the National Association of State Comptrollers), beginning at 8:30 a.m. local time.
- March 30–31, 2021, in Atlanta, GA, beginning at 8:30 a.m. local time.
- April 8, 2021, in New York, NY, beginning at 8:30 a.m. local time.
- April 13–14, 2021, in Chicago, IL, beginning at 8:30 a.m. local time.
- April 20–21, 2021, in San Francisco, CA, beginning at 8:30 a.m. local time.

#### **User forums are tentatively scheduled as follows:**

- April 9, 2021, in New York, NY, beginning at 8:30 a.m. local time.
- April 15, 2021, in Chicago, IL, beginning at 8:30 a.m. local time.

**Public hearings.** The public hearings are being conducted in conjunction with the public hearings on the Exposure Draft of the proposed Statement, *Financial Reporting Model Improvements* (Reporting Model Exposure Draft). Public hearings on the Preliminary Views, *Revenue and Expense Recognition*, also will be conducted on the same days to allow interested individuals or organizations to participate in both public hearings. Because there is a degree of interaction between the documents, respondents may wish to consider reviewing all documents before developing responses. Those individuals or organizations may participate in person, by videoconference (if available at the location), or by telephone. Details regarding participation will be provided after the Governmental Accounting Standards Board (GASB) receives a notice of intent to participate.

**User forums.** The user forums are being conducted primarily for interested individuals or organizations from the financial statement user community. Interested individuals or organizations may participate in person, by videoconference (if available at the location), or by telephone. Participation in person is encouraged. Details regarding participation will be provided after the GASB receives a notice of intent to participate.

**Deadline for written notice of intent to participate in the public hearings and user forums:** February 26, 2021.

**Basis for public hearings and user forums.** The GASB has scheduled the public hearings and user forums to obtain information from interested individuals and organizations about the issues discussed in this Exposure Draft and in the reporting model Exposure Draft. The

hearings and forums will be conducted by one or more members of the GASB and its staff. Interested parties are encouraged to participate at a hearing or forum and through written response.

**Public hearing oral presentation requirements.** Individuals or organizations that want to make an oral presentation in person, by videoconference (if available at the location), or by telephone at a public hearing are required to provide, **by the deadline for notice of intent to participate (February 26, 2021)**, a written notification of that intent, accompanied by their written submission in response to this Exposure Draft. A copy of additional comments that will be made at the public hearing addressing the issues discussed in this Exposure Draft should be provided two weeks before the hearing. The notification, written submission, and additional comments should be addressed to the Director of Research and Technical Activities, Project No. 3-20, and emailed to [director@gasb.org](mailto:director@gasb.org). The notification should indicate the location of the hearing at which the respondent would like to participate and a preference for participating in person, by videoconference (if available at the location), or by telephone. A public hearing may be cancelled if sufficient interest is not expressed by the deadline.

The GASB intends to schedule all respondents who want to make oral presentations at a public hearing and will notify each individual or organization of the expected time of their presentation. The presentation may address issues discussed in this Exposure Draft, the Reporting Model Exposure Draft, or both documents. The time allotted to each individual or organization will be limited to approximately 30 minutes for each document—10 minutes to summarize or elaborate on the written submissions, or to comment on the written submissions or presentations of others, and 20 minutes to respond to questions from those conducting the hearing.

**User forum participation requirements.** Participation in a user forum is limited to external financial statement users, such as municipal bond analysts, taxpayer group members, and legislators. All participants are asked to engage in a discussion of the issues raised in this Exposure Draft, additional issues raised by the Board members and staff, and issues raised by other participants. Every participant will be provided with the opportunity to express his or her views.

Individuals who want to participate in a user forum should provide, **by the deadline for notice of intent to participate (February 26, 2021)**, a written notification of that intent (addressed to the Director of Research and Technical Activities, Project No. 3-20, and emailed to [director@gasb.org](mailto:director@gasb.org)). The notification should indicate the location of the user forum at which the respondent would like to participate and a preference for participating in person, by videoconference (if available at the location), or by telephone. Participation in person is encouraged.

**Observers.** Observers are welcome at the public hearings and user forums and are urged to submit written comments.

## WRITTEN COMMENTS

**Deadline for submitting written comments:** February 26, 2021.

**Requirements for written comments.** Any individual or organization that wants to provide written comments should provide those comments by **February 26, 2021**. Comments should be addressed to the Director of Research and Technical Activities, Project No. 3-20, and emailed to [director@gasb.org](mailto:director@gasb.org).

## OTHER INFORMATION

**Public files.** Written comments and a transcript of the public hearings will become part of the GASB's public file. Written comments also are posted on the GASB's website.

This Exposure Draft may be downloaded from the GASB's website at [www.gasb.org](http://www.gasb.org).

Final GASB publications may be ordered at [www.gasb.org](http://www.gasb.org).

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## **Notice to Recipients of This Exposure Draft**

The GASB is responsible for (1) establishing and improving standards of state and local governmental accounting and financial reporting to provide useful information to users of financial reports and (2) educating stakeholders—including issuers, auditors, and users of those financial reports—on how to most effectively understand and implement those standards.

The due process procedures that we follow before issuing our standards, concepts, and other communications are designed to encourage broad public participation. As part of that due process, the GASB is issuing this Exposure Draft setting forth proposed concepts on recognition of elements of financial statements.

We invite your comments on all matters in this proposed Concepts Statement. Because this proposed Concepts Statement may be modified before it is issued as a final Concepts Statement, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe the GASB should consider.

All responses are distributed to all Board members and to staff members assigned to this project, and all comments are considered during the Board's deliberations leading to a final Concepts Statement. Only after the Board is satisfied that all alternatives have adequately been considered, and modifications have been made as considered appropriate, will a vote be taken to issue a final Concepts Statement. A majority vote of the Board is required for adoption.

## Summary

This proposed Concepts Statement would be one of a series of Concepts Statements that the Governmental Accounting Standards Board (GASB) has issued or will issue. Concepts Statements are intended to provide a conceptual framework of interrelated objectives and fundamental principles that can be used to establish consistent accounting and financial reporting standards.

Concepts Statements identify the objectives and fundamental principles of financial reporting that can be applied to address numerous accounting and financial reporting issues. They assist the GASB in considering the merits of alternative approaches to financial reporting and facilitate the development of well-reasoned accounting and financial reporting standards. Concepts Statements also assist preparers, auditors, and users to better understand the fundamental concepts underlying accounting and financial reporting standards. Concepts Statements do not prescribe the accounting and financial reporting standards that apply to a particular item or event.

This proposed Concepts Statement addresses concepts for recognition of elements of financial statements. Recognition concepts encompass two aspects of state and local government financial statements:

- The *measurement focus* of a specific financial statement determines *what* items should be reported as elements of that financial statement.
- The related *basis of accounting* determines *when* those items should be reported.

This proposed Concepts Statement also addresses both the economic resources measurement focus and accrual basis of accounting and the short-term financial resources measurement focus and accrual basis of accounting.

Under the economic resources measurement focus and accrual basis of accounting, elements of financial statements would be recognized when an item meets the definition of an element and the measurement of the item sufficiently reflects the qualitative characteristics of information in financial reports, subject to the limitations of financial reporting described in Concepts Statement No. 1, *Objectives of Financial Reporting*.

The short-term financial resources measurement focus and accrual basis of accounting would report elements of financial statements from a short-term perspective that is uniform across governments. Under the short-term financial resources measurement focus and accrual basis of accounting, elements of financial statements would be recognized when an item meets the definition of an element within the context of this measurement focus and basis of accounting and the measurement of the item sufficiently reflects the qualitative characteristics of information in financial reports, subject to the limitations of financial reporting described in Concepts Statement 1.

The recognition concepts for the short-term financial resources measurement focus and accrual basis of accounting would be based on whether items arise from short-term or long-term transactions and other events. Balances, outflows of resources, and inflows of resources from short-term transactions and other events would be recognized *as the underlying transaction or other event occurs*. Balances, outflows of resources, and inflows of resources from long-term transactions and other events would be recognized *when payments are due*.

Additionally, when evaluating an item for recognition in financial statements, the item would be evaluated using a hierarchy for recognition of elements. An item first would be evaluated against the definitions of assets and liabilities, then the definitions of deferred outflows of resources and deferred inflows of resources, and lastly the definitions of outflows of resources and inflows of resources. The item would be recognized as the first element for which it meets the definition. If the item does not meet any of the definitions, it would not be recognized.

### **How This Proposed Concepts Statement Would Improve Financial Reporting**

This proposed Concepts Statement would improve financial reporting by enhancing the framework through which the GASB maintains consistency in standards setting. For example, the financial statements presented applying the short-term financial resources measurement focus and accrual basis of accounting would reflect the amount of fund balance at period-end that is available for spending in the next period using a standardized approach, which may or may not be restricted for specific purposes, as well as fund balance that is legally or contractually required to be maintained intact. The concepts also may benefit preparers and auditors in certain circumstances when evaluating transactions for which there are no existing standards (based on the hierarchy of generally accepted accounting principles).

# Proposed Concepts Statement of the Governmental Accounting Standards Board

## Recognition of Elements of Financial Statements

June 17, 2020

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# **Proposed Concepts Statement of the Governmental Accounting Standards Board**

## **Recognition of Elements of Financial Statements**

**June 17, 2020**

### **INTRODUCTION**

1. The objective of this Concepts Statement is to establish concepts for recognition of elements of financial statements, a necessary building block of the conceptual framework for reporting items in financial statements.
2. Concepts Statements do not establish authoritative guidance for accounting and financial reporting. This Concepts Statement primarily is intended to provide the GASB with criteria to consistently apply in evaluating items for recognition in financial statements in the standards-setting process. The fundamental concepts also may be used by preparers, auditors, and users in understanding the conceptual foundation for items recognized in financial statements.

### **PURPOSE AND SCOPE OF THIS CONCEPTS STATEMENT**

3. This Concepts Statement provides a framework of interrelated objectives and fundamental principles that can be used to establish consistent accounting and financial reporting principles for recognition of elements of financial statements. The conceptual framework facilitates the development of accounting and financial reporting standards and the consideration of the merits of alternative approaches to accounting and financial reporting. Concepts Statements may be used by preparers and auditors when applying the generally accepted accounting principles (GAAP) hierarchy in assessing transactions and other events for which the GASB does not provide authoritative guidance. Concepts Statements also may be used by all stakeholders to better understand the fundamental concepts underlying accounting and financial reporting standards in the governmental environment. Concepts Statements are not used to prescribe the accounting and financial reporting standards that apply to a particular item or event.
4. This Concepts Statement establishes concepts for recognition of elements of financial statements issued by state and local governments.
5. This Concepts Statement amends Concepts Statement No. 4, *Elements of Financial Statements*, paragraphs 27 and 39.

## **RECOGNITION OF ELEMENTS OF FINANCIAL STATEMENTS**

### **Measurement Focus and Basis of Accounting Descriptions**

6. The measurement focus of a specific financial statement determines *what* items should be reported as elements of that financial statement. The related basis of accounting determines *when* those items should be reported.

### **Economic Resources Measurement Focus and Accrual Basis of Accounting**

#### **Definition**

7. The economic resources measurement focus incorporates all outflows of resources and inflows of resources and all assets, deferred outflows of resources, liabilities, and deferred inflows of resources. Under an accrual basis of accounting, items are recognized when the underlying transaction or other event occurs.

#### **Recognition Concepts**

8. In financial statements presented applying the economic resources measurement focus and accrual basis of accounting, an item should be recognized and, therefore, reported as an element of the financial statements if it meets both of the following criteria:

- a. The item meets the definition of an element (as set forth in Concepts Statement 4) within the context of the economic resources measurement focus and accrual basis of accounting.
- b. The measurement of the item sufficiently reflects the qualitative characteristics of information in financial reporting, subject to the limitations of financial reporting, described in Concepts Statement No. 1, *Objectives of Financial Statements*.

### **Short-Term Financial Resources Measurement Focus and Accrual Basis of Accounting**

#### **Definition**

9. The short-term financial resources measurement focus incorporates outflows of short-term financial resources and inflows of short-term financial resources and all short-term financial assets, deferred outflows of resources, liabilities, and deferred inflows of resources. Under an accrual basis of accounting, elements of financial statements arising from short-term transactions and other events are recognized *as they occur*, and elements of financial statements arising from long-term transactions and other events are recognized *when payments are due*. Financial assets in this measurement focus include cash, assets that are available to be converted to cash, and assets that are consumable in lieu of cash. All liabilities in this measurement focus are financial liabilities.

## **Recognition Concepts**

10. In financial statements presented applying the short-term financial resources measurement focus and accrual basis of accounting, an item should be recognized and, therefore, reported as an element of the financial statements if it meets both of the following criteria:

- a. The item meets the definition of an element (as set forth in Concepts Statement 4) within the context of the short-term financial resources measurement focus and accrual basis of accounting.
- b. The measurement of the item sufficiently reflects the qualitative characteristics of information in financial reporting, subject to the limitations of financial reporting, described in Concepts Statement 1.

11. In financial statements presented applying the short-term financial resources measurement focus and accrual basis of accounting, recognition of elements is based on whether transactions and other events are short term or long term.

- a. Short-term transactions and other events are those for which the period from inception to conclusion is one year or less.
- b. Long-term transactions and other events are those for which the period from inception to conclusion is greater than one year.

## **Amendment to Concepts Statement 4**

12. For resource flows statements presented applying the short-term financial resources measurement focus, the period to which an outflow (or inflow) of resources arising from either a short-term or a long-term transaction or other event applies is determined using the concept of interperiod equity.

## **Hierarchy of Recognition**

13. In applying both the economic resources measurement focus and accrual basis of accounting and the short-term financial resources measurement focus and accrual basis of accounting to determine what type of element an item is, if any, the item should be evaluated in the following order:

- a. The item first should be evaluated to determine whether it meets the definition of an asset or a liability within the context of the applicable measurement focus and basis of accounting. If the item meets the definition of an asset or a liability, it should be recognized as an asset or a liability.
- b. If the item does not meet the definition of an asset or a liability, it should be evaluated to determine whether it meets the definition of a deferred outflow of resources or a deferred inflow of resources within the context of the applicable measurement focus and basis of accounting. If the item meets the definition of a deferred outflow of resources or a deferred inflow of resources, it should be recognized as a deferred outflow of resources or a deferred inflow of resources.

- c. If the item does not meet the definition of a deferred outflow of resources or a deferred inflow of resources, the item should be evaluated to determine whether it meets the definition of an outflow of resources or an inflow of resources within the context of the applicable measurement focus and basis of accounting. If the item meets the definition of an outflow of resources or an inflow of resources, it should be recognized as an outflow of resources or an inflow of resources.
- d. If the item does not meet the definition of an outflow of resources or an inflow of resources, the item should not be recognized in the financial statements.

## Appendix A

### BACKGROUND

A1. The Board initiated research activities on concepts related to measurement attributes in December 2003 and on concepts related to recognition in August 2005. After considering feedback from the Governmental Accounting Standards Advisory Council (GASAC) at various meetings and the interrelatedness of the issues, the Board combined the research activities in December 2005. Deliberations on that current technical agenda project began in December 2007.

A2. From December 2007 through June 2011, the Board discussed and reached tentative conclusions on recognition and measurement concepts. Discussions included consideration of the results of research interviews conducted with users of financial statements on their views regarding recognition in financial statements presented applying the current financial resources measurement focus and modified accrual basis of accounting. Throughout those discussions, the Board also considered comments received from members of a project task force comprising experts broadly representative of the GASB's stakeholders. In addition, the Board regularly updated the GASAC on project developments and received feedback from GASAC members during the GASAC's regular meetings. When project issues are discussed with task force members and GASAC members, those groups do not take formal positions either in support of or in opposition to those issues.

A3. In June 2011, the Preliminary Views, *Recognition of Elements of Financial Statements and Measurement Approaches* (the 2011 Preliminary Views), was issued. Thirty-eight responses were received, and five individuals and organizations testified at public hearings held in October 2011. In addition, 20 users of financial statements were interviewed regarding their views on the proposals in that Preliminary Views.

A4. In December 2012, the Board again reconsidered the scope of the project and returned to a two-project approach: one on measurement concepts and the other on recognition concepts, with separate Exposure Drafts and Concepts Statements to be issued for each. Based on the feedback received on the 2011 Preliminary Views, the Board determined that the timeline for completion of the two projects was no longer similar and that it would not be beneficial to delay finalizing measurement concepts during the additional time that would be needed to further develop recognition concepts. The Board issued Concepts Statement No. 6, *Measurement of Elements of Financial Statements*, on measurement in March 2014.

A5. In August 2013, further discussions on recognition of elements of financial statements were suspended pending future coordination with the then-proposed reexamination of the financial reporting model. Part of the financial reporting model reexamination pre-agenda research that was conducted in 2013–2015 involved stakeholder surveys. Those surveys included questions regarding the recognition concepts for the near-term financial resources measurement focus—the recognition approach that was proposed in the 2011 Preliminary Views. The Invitation to Comment, *Financial Reporting Model Improvements—*

*Governmental Funds*, issued in December 2016 as part of the financial reporting model reexamination project, presented three recognition approaches for governmental funds: the near-term financial resources, short-term financial resources (working capital), and long-term financial resources recognition approaches. After redeliberations on the issues in the Invitation to Comment, the Board decided to propose in a Preliminary Views (the reporting model Preliminary Views) that financial statements of governmental funds be presented applying the short-term financial resources measurement focus, which combined certain aspects of the proposals presented in the Invitation to Comment. Further details about the financial reporting model reexamination project are presented in the Exposure Draft, *Financial Reporting Model Improvements*, issued in conjunction with this conceptual framework Exposure Draft.

A6. In January 2018, the Board determined that the recognition concepts associated with the proposed measurement focus set forth in the reporting model Preliminary Views were sufficiently different from the recognition concepts for the near-term financial resources measurement focus presented in the 2011 Preliminary Views and that it was appropriate to reissue a Preliminary Views on recognition concepts.

A7. In September 2018, the Board approved a Preliminary Views, *Recognition of Elements of Financial Statements* (the 2018 Preliminary Views). The 2018 Preliminary Views proposed recognition concepts for the economic resources measurement focus, the short-term financial resources measurement focus, and the hierarchy of recognition. The 2018 Preliminary Views also included an Alternative View associated with the short-term financial resources measurement focus. The Board received 46 written responses to the 2018 Preliminary Views from organizations and individuals. In addition, the Board received oral responses from and had the opportunity to further explore the views of 13 individuals or groups at 3 public hearings.

A8. Feedback from the GASAC was sought at several of its meetings throughout the Board's deliberations that led to the Exposure Draft of this Concepts Statement. In addition, the Board assembled a new task force for both this project and the financial reporting model reexamination project to gather input from individuals broadly representative of the GASB's stakeholders. The task force members met with the Board in June 2016 and September 2017 to discuss the Board's tentative decisions and provided feedback on issues discussed by the Board on a continual basis throughout the project. The Board's consideration of the individual feedback from both the GASAC members and task force members is incorporated throughout Appendix B.

## **Appendix B**

### **BASIS FOR CONCLUSIONS AND ALTERNATIVE VIEW**

#### **Basis for Conclusions**

##### **Introduction**

B1. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Concepts Statement. It includes discussion of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

##### **Economic Resources Measurement Focus**

B2. The Board concluded that the definition of *economic resources measurement focus* should clarify that the measurement focus recognizes all items meeting the definition of each of the elements of financial statements, not a subset of those items. The Board concluded that it is appropriate to consider all of the qualitative characteristics of information in financial reporting—understandability, reliability, relevance, timeliness, consistency, and comparability—when assessing measurability of an item, as well as to consider the limitations of financial reporting in the context of the economic resources measurement focus and accrual basis of accounting. The Board concluded that for a transaction or other event to have occurred, the related element should meet the recognition concepts as set forth in this Concepts Statement.

##### **Concerns with the Existing Reporting of Governmental Fund Information**

B3. The concepts for recognition of elements of financial statements presented applying the short-term financial resources measurement focus and accrual basis of accounting are designed to address conceptual concerns with the prior reporting of governmental fund information.

##### ***Effectiveness of Governmental Fund Information***

B4. After extensive stakeholder outreach and consideration of that input, the Board determined that governmental fund financial statements have not been as effective as they could have been in providing information that is essential for decision making and assessing a government's fiscal accountability. The term *fiscal accountability* refers to 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 resources in the short term (usually one budgetary cycle or one year). The information in those statements maintains a shorter time perspective than the government-wide financial statements and focuses on financial resources rather than economic resources. Some participants in the pre-agenda research noted that the effectiveness of the governmental fund financial statements was diminished by conceptual inconsistencies and the absence of guidance for complex transactions, as discussed below. Furthermore, while not directly

associated with concepts, the Board concluded in establishing financial reporting model standards that it was not sufficiently clear from the descriptions used in financial statements that the information provided was from a short-term perspective. If the governmental fund financial statements were relied on exclusively by certain users, the potential for making decisions and assessments with incomplete information existed.

### ***Conceptual Consistency***

B5. The current financial resources measurement focus and modified accrual basis of accounting for reporting in governmental funds did not have a conceptual foundation. Rather, it was applied as a collection of accounting conventions. The accounting principles that were applied through the current financial resources measurement focus and modified accrual basis of accounting reflected the goal of maintaining what traditionally had been a shorter time perspective in the governmental fund financial statements than is found in financial statements presented applying the economic resources measurement focus and accrual basis of accounting. For example, the proceeds from an issuance of long-term debt were reported as other financing sources in the governmental fund statement of revenues, expenditures, and changes in fund balances, whereas repayments of long-term debt were reported as expenditures. In that financial statement, acquisitions of capital assets also were reported as expenditures. This reflected the fact that, from a shorter time perspective, those transactions produce or require the use of current financial resources. Yet, those statements still included the effects of transactions involving certain assets, such as long-term receivables, that did *not* reflect a shorter time perspective. Consequently, the resultant information conveyed in financial statements presented applying the current financial resources measurement focus and modified accrual basis of accounting was conceptually inconsistent.

B6. As a result of the application of those accounting conventions, concerns were expressed by some stakeholders that financial statements presented applying the current financial resources measurement focus and modified accrual basis of accounting reported assets that did not consistently reflect a shorter time perspective. Some inconsistencies arose because the accounting conventions associated with the current financial resources measurement focus and modified accrual basis of accounting for reporting governmental funds were developed before financial statements for most governmental activities were required to be reported applying the economic resources measurement focus and accrual basis of accounting in the government-wide financial statements. Other issues arose because the recognition guidance for certain transactions was developed after the account group limitations were established. For example, when the general fixed assets account group was part of governmental financial reporting, prior to the implementation of Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, the reporting was limited to reporting general fixed assets.

### ***Guidance for Complex Transactions***

B7. Another concern raised about governmental fund financial statements was how to report the effects of more complex transactions, such as those involving derivative instruments. Existing guidance for those transactions does not address reporting in

governmental funds, and there were no concepts on which to base any authoritative guidance. Because those complex transactions are unlike the transactions for which guidance for reporting in governmental funds existed, it would not have been appropriate to apply the current financial resources measurement focus and modified accrual basis of accounting conventions to them. As a result, the Board concluded that a conceptual foundation of what should be recognized in governmental fund financial statements was needed to determine the appropriate accounting standards for those transactions.

### ***Lack of Consistency in Short-Term Perspective***

B8. Under the current financial resources measurement focus and modified accrual basis of accounting, revenue was recognized when the underlying transaction or other event occurred and it was both measurable and available. *Available* meant that payment was received during the reporting period or soon enough thereafter to be used to finance expenditures of the reporting period. Previous guidance required the use of a period of availability of up to 60 days beyond period-end for recognition of property tax revenues. In addition, governments were allowed to adopt another accounting policy that reflected a different period of availability for other revenue sources. Some governments adopted a policy reflecting a short period of availability, such as 60 or 90 days, for those other revenue sources, whereas other governments adopted a policy reflecting a longer period of availability, such as one year. The Board determined that comparability of information among governments was reduced because governments did not use the same period of availability for revenue recognition.

### **Alternatives Considered and Rejected**

B9. During the development of the measurement focus and basis of accounting for governmental funds, the Board considered several alternatives, including a budget-focused model, a near-term financial resources-focused model, a total financial resources-focused model, an economic resources-focused model, and a model that combined some aspects of these other models.

### ***Measurement Focus and Basis of Accounting Used for a Government's Budget***

B10. An alternative considered by the Board for addressing the issues with governmental fund financial statements was to present those financial statements applying a government's budgetary measurement focus and basis of accounting. This would have maintained the traditional emphasis of governmental fund financial statements on fiscal accountability. It also would have had the potential to simplify financial reporting and reduce costs for preparers. However, the Board rejected this alternative because this approach would have substantially reduced comparability of governmental fund information among governments given that not all governments budget using the same measurement focus and basis of accounting. Additionally, some governments are required to budget using GAAP for governmental funds. Those governments would no longer have a GAAP basis for budgeting. Furthermore, the Board concluded that this alternative would not have addressed the concerns with conceptual consistency, guidance for complex transactions, or lack of consistency that are addressed in the short-term perspective.

### ***Near-Term Financial Resources Measurement Focus and Accrual Basis of Accounting***

B11. Another alternative considered by the Board was to present the financial statements applying the near-term financial resources measurement focus and accrual basis of accounting. This approach would have applied a recognition period of 60–90 days from the date of the financial statements and would have applied recognition terms based on what is normal for all governments. Information provided by financial statements presented applying the near-term financial resources measurement focus and accrual basis of accounting would have been useful for assessing fiscal accountability and would have provided an amount for fund balance that is useful for assessing amounts available for spending in future periods on a basis that is closer to how many governments budget. The concerns with this approach focused on the complexity of application. Use of a recognition period of 60–90 days was considered problematic for some transactions, such as certain grants. Use of recognition terms based on what is normal for all governments was determined to be particularly challenging. The term *normally* was used in the past, in conjunction with the provision “normally [expected] to be liquidated with expendable available financial resources” beginning with NCGA Statement 4, *Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences*, in 1982. However, determining what recognition terms are normal for governments of different sizes, types, and geographic locations for every class of transaction would consume significant time and resources of the Board, preparers, or auditors with resulting costs both in the initial implementation period and in each period thereafter. Furthermore, some stakeholders questioned the value of presenting certain transactions in a manner different from the terms of the government’s binding arrangement in cases in which the terms of the binding arrangement are not the same as what is considered to be normal for all governments.

### ***Total Financial Resources Measurement Focus and Accrual Basis of Accounting***

B12. Another alternative considered by the Board was to present the financial statements applying the total financial resources measurement focus and accrual basis of accounting. This alternative would have recognized all financial assets and liabilities except for capital-related debt. Under this alternative, acquisition of capital assets and issuance of capital-related debt would have been reported as outflows of resources and inflows of resources, rather than assets and liabilities. The Board rejected this alternative because of several concerns. One concern was that this alternative failed to provide a shorter time perspective and information useful for assessing fiscal accountability. For example, fund balance applying this alternative would not be useful for assessing short-term financial health because it would reflect the recognition of long-term liabilities such as long-term debt, net pension obligations, and net other postemployment benefit (OPEB) obligations but would not reflect the future inflows of resources that are expected to be used to pay those liabilities. In order to provide short-term information, the Board determined that a governmental fund statement of cash flows would be needed. However, the Board believes that the expected benefits of the incremental information provided in a statement of cash flows would not justify the perceived costs of preparing and auditing that information.

### ***Economic Resources Measurement Focus and Accrual Basis of Accounting***

B13. Another alternative considered by the Board was to present the financial statements applying the economic resources measurement focus and accrual basis of accounting. According to the pre-agenda research, the traditional emphasis of governmental fund financial statements on fiscal accountability continues to provide valuable information. Some stakeholders stated that reporting by major fund, as well as applying a measurement focus and basis of accounting that meets the objective of demonstrating fiscal accountability provided particularly valuable information. The operational accountability information that would have been provided by the economic resources measurement focus and accrual basis of accounting was considered by the Board but was determined to be inconsistent with governmental fund reporting. In order to demonstrate operational accountability for governmental activities, the Board believes that financial statements would need to be presented by major activities, at a minimum. The fact that each governmental fund generally reports only a portion of a major governmental activity is inconsistent with this perspective. In addition, the evaluation of economic transactions, rather than shorter term inflows and outflows, is key to evaluating operational accountability. Furthermore, the government-wide financial statements are presented applying the economic resources measurement focus and accrual basis of accounting, which is consistent with the objective of demonstrating operational accountability.

B14. Another concern with the application of the economic resources measurement focus and accrual basis of accounting is the effect it would have had on fund structure and related linkage to budgetary reporting. The Board believes that reporting capital assets and long-term liabilities in governmental funds, two significant changes to current reporting in governmental fund financial statements, would have posed challenges. Reporting those items in the fund that is used to acquire a capital asset or make payments on long-term financings would have resulted in a presentation much like the reporting of the general fixed asset and general long-term debt account groups in the reporting model prior to Statement 34. That presentation would not have resulted in activities accounted for in the general fund and special resources funds being reported on an economic resources measurement focus and accrual basis of accounting. If those items were reported as part of the functions or activities that use those capital assets or generate the resources used for debt service, the existing fund structure would have been substantially changed, such that linkage to budgetary reporting generally would have been lost. As a result, the Board concluded that neither approach would be consistent with the objective of improving the financial reporting model to meet or more fully meet as many of the objectives of financial reporting as possible.

B15. An additional concern with the application of the economic resources measurement focus and accrual basis of accounting is the loss of information about the flows of financial resources associated with capital assets and related long-term liabilities. That information could be provided by additionally requiring the presentation of a statement of cash flows for governmental funds. However, the Board believes that the expected benefits of the incremental information provided in a statement of cash flows would not justify the perceived costs of preparing and auditing that information.

### ***Combination of Approaches***

B16. Another alternative considered by the Board was to combine certain approaches—providing information using the budgetary measurement focus and basis of accounting, as well as a standardized shorter term measurement focus and basis of accounting, and a long-term financial-resources-based measurement focus and basis of accounting. Presenting governmental fund information using multiple measurement focuses and bases of accounting would have eliminated potential deficits in information provided by any single measurement focus and basis of accounting. However, the Board concluded that this approach would have been overly complex for most stakeholders and would have resulted in unnecessary confusion to users regarding which amounts within the various approaches in the presentation are the most representationally faithful. Another concern with this approach is the added costs for governments to prepare and audit multiple, rather than one, measurement focus and basis of accounting presentations for governmental fund financial statements.

### **Development of the Short-Term Financial Resources Measurement Focus and Accrual Basis of Accounting**

B17. In the 2018 Preliminary Views, the Board proposed a definition of the short-term financial resources measurement focus as a measurement focus that incorporated elements of financial statements arising from short-term transactions and other events as they occur and elements of financial statements arising from long-term transactions and other events when payments are due. Items arising from short-term transactions and other events were described as those that *normally* are due to convert to or generate cash (or other financial assets) or require the use of cash (or other financial assets) entirely within one year from the inception of the transaction or other event. Items arising from long-term transactions and other events were described as those *normally* due to convert to or require the use of cash (or other financial assets) in periods that extend beyond one year from the inception of the transaction or other event.

B18. The 2018 Preliminary Views included alternative views with respect to the short-term financial resources measurement focus. The alternative views proposed modifying the short-term financial resources measurement focus to include the portion of all financial assets and liabilities that matures or is otherwise expected to be paid in cash or other fund financial resources within one year from the date of the financial statements, with the exception of pension, OPEB, and asset retirement obligations. The second modification proposed in the alternative views was to replace the concept of *normally* with (a) the stated or contractual maturities of financial assets and liabilities or (b) the best estimate of periods of receipt or payment if there are no stated or contractual maturities.

### ***Combination of Features***

B19. After considering the feedback on the 2018 Preliminary Views regarding the short-term financial resources measurement focus and the alternative views from public hearings, user forums, comment letters, and participants in a field test of the reporting model Preliminary Views, the Board evaluated each of the following major features of the

preliminary and alternative views: the recognition terms, the recognition method, and the recognition period.

### **Recognition terms**

B20. The short-term financial resources measurement focus as described in the 2018 Preliminary Views based recognition terms on what is normal for governments in general. However, the alternative views based recognition terms on contractual terms (or estimated payments when there are no contractual terms). As previously noted, feedback on the 2018 Preliminary Views indicated a number of concerns with the use of *normally* in recognition terms, including (a) determining which transactions constituted a class of transactions would be challenging; (b) what is normal for certain types of governments, such as states, may not be normal for other governments, such as cities; and (c) applying what is normal for many governments may produce confusing results for outlier transactions. Feedback also identified certain limitations to the use of contractual terms for recognition. After considering the challenges to both alternatives, the Board decided that recognition terms should be based on contractual terms—or, more broadly, the terms of the binding arrangement or estimated payments if either there is no binding arrangement or the binding arrangement does not include specific payment terms.

### **Recognition method**

B21. Both the short-term financial resources measurement focus as described in the 2018 Preliminary Views and the alternative views would have recognized items resulting from short-term transactions using the same criterion—when the underlying transaction or other event occurs. However, the recognition method for items resulting from long-term transactions and other events was different. The short-term financial resources measurement focus as described in the 2018 Preliminary Views would have recognized items arising from long-term transactions and other events when payment is due. The alternative views would have recognized items arising from long-term transactions and other events (with the exception of postemployment benefits and asset retirement obligations) for which payments are due within the subsequent reporting period. The Board decided that recognition terms for long-term transactions and other events should be based on when payments are due. The primary considerations were that (a) recognizing payments due within the subsequent reporting period would be conceptually inconsistent, in that amounts due for postemployment benefits and asset retirement obligations cannot be determined on that basis and, therefore, would be excluded, and (b) in many cases, using a one-year period from the date of the fiscal year-end could be viewed as presenting information that was not a faithful representation of a short-term model.

### **Recognition period**

B22. Both the short-term financial resources measurement focus as described in the 2018 Preliminary Views and the alternative views would have used a recognition period of one year. The short-term financial resources measurement focus as described in the 2018 Preliminary Views would have applied the recognition period in distinguishing between short-term and long-term transactions and other events. The alternative views would have

applied the recognition period to long-term transactions and other events by requiring the accrual of payments expected to be made in the subsequent reporting period. When considering which recognition characteristics to include in this Concepts Statement, the Board also evaluated a near-term recognition period of 60–90 days—one of the alternatives in the Invitation to Comment. The near-term recognition period may be more consistent with recognition under a government’s budgetary basis and is closer to the previous guidance for recognition in governmental funds. However, the Board determined that a one-year recognition period should be applied because it will eliminate certain inconsistencies in current practice, such as recognizing inflows of resources and receivables related to some grants. Also, the Board believes that it is the application of the recognition method “when payments are due” for long-term transactions that is most significant in maintaining a relationship with budgetary reporting.

### ***Basis of Accounting***

B23. The Board determined that recognition concepts should explicitly acknowledge the use of a basis of accounting in conjunction with the application of a measurement focus. In prior due process documents, the basis of accounting was incorporated only implicitly. Therefore, this Concepts Statement references the combined phrase *short-term financial resources measurement focus and accrual basis of accounting*. Prior guidance for governmental funds used the term *current financial resources measurement focus and modified accrual basis of accounting*. Because that guidance was not conceptually based, significant modifications to the accrual basis of accounting were needed, and, therefore, the term *modified accrual basis of accounting* was appropriate in those circumstances. The distinction between the short-term financial resources measurement focus and the economic resources measurement focus is established by concepts in paragraphs 10–12, and, therefore, the Board determined that the term *accrual basis of accounting* is appropriate when used in the context of the short-term financial resources measurement focus.

### ***Messages Conveyed by Governmental Fund Financial Statements***

B24. The Board believes that financial statements presented applying the short-term financial resources measurement focus and accrual basis of accounting report financial balance sheet elements and flows of financial resources of governmental fund activities from a short-term perspective that can be consistently applied by governments. Financial statements presented applying this measurement focus and basis of accounting report (a) balances from short-term transactions and other events accumulated at period-end and (b) inflows and outflows of resources from short-term transactions and other events *as they occur* and from long-term transactions and other events *when payments are due*.

B25. The Board believes that financial statements presented applying the short-term financial resources measurement focus and accrual basis of accounting enable assessment of the amount of fund balance at period-end that is available for spending in the next period, which may or may not be restricted for specific purposes, as well as fund balance that is legally or contractually required to be maintained intact, in the context of a consistent and conceptually sound model from a short-term perspective. Furthermore, because this measurement focus and basis of accounting presents a shorter time perspective and

recognizes items of a long-term nature when payments are due, the Board believes that it will provide financial results that may be useful in evaluating budgetary information, which usually relates to shorter periods as well.

### ***Features of the Measurement Focus and Basis of Accounting***

#### **Relationship with budgetary information**

B26. The significance of governmental fund budgets is an important factor that distinguishes governments from the private sector. Budgets are integral to managing a government; however, not all governments take the same approach to budgeting. Consequently, the Board believes that comparisons of budgetary information to financial statement information applying a measurement focus and basis of accounting that is more comparable among governments may aid in identifying differences in budgetary practices and, therefore, provide information useful in understanding a government's budgetary practices. The short-term financial resources measurement focus and accrual basis of accounting provides a measure of fund balance that enables an assessment of the amount of short-term financial resources fund balance at period-end that is available for spending in the subsequent period. The Board believes that information in the resource flows statement also may be valuable in evaluating a government's budgetary results because the outflows of resources and inflows of resources recognize flows from long-term transactions and other events when payments are due, similar to how many governments budget.

#### **Conceptual consistency**

B27. The Board believes that the short-term financial resources measurement focus and accrual basis of accounting provides conceptually consistent recognition principles for governmental fund financial statements, replacing the previous collection of accounting conventions. The balances associated with long-term transactions and other events, such as loans receivable, will be recognized in a consistent manner in the governmental fund financial statements. Furthermore, the Board believes that this measurement focus and basis of accounting provides a foundation for developing guidance for governmental funds to report the effects of more complex transactions and other events. As previously noted, transactions involving derivative instruments and other complex transactions and events for which guidance is not currently provided can be addressed using those recognition principles.

#### **Consistent application**

B28. The short-term financial resources measurement focus and accrual basis of accounting uses a broad definition of financial assets that includes assets expected to be consumed in lieu of cash. It replaces prior guidance that allowed governments alternative ways to account for certain assets, such as inventory. This measurement focus and basis of accounting also uses a recognition window of one year from the inception to the conclusion of the transaction or other event in distinguishing short-term and long-term transactions and other events, which is fundamental to the measurement focus and basis of accounting. The Board

believes that those features enhance the ability of the measurement focus and basis of accounting to be applied consistently from one government to another.

B29. The Board concluded that the assessment of whether a transaction or other event is short term or long term should depend on the amount of time that lapses between inception and conclusion. If that time period is one year or less, the transaction or other event would be identified as short term. If the time period is more than one year, the transaction or other event would be identified as long term.

### **Reflects a government's unique circumstances**

B30. The short-term financial resources measurement focus and accrual basis of accounting recognizes elements of financial statements using the specific terms of a government's binding arrangements (or estimated payments when either there is no binding arrangement or the binding arrangement does not have specific payment terms). As previously noted, past guidance required the recognition of specific liabilities to the extent that they are normally expected to be liquidated with expendable available financial resources based on how governments generally operate. Consequently, the Board concluded that, from a conceptual standpoint, when governments engage in transactions that differ from what is normal for governments in general, the financial statements will appropriately reflect those differences.

### **Relationship with the objectives of financial reporting**

B31. The objectives of financial reporting set forth in Concepts Statement 1 are multifaceted and can be achieved only through a variety of financial statements and other communication methods. Governmental fund financial statements are expected to achieve certain objectives of financial reporting and contribute to the achievement of other objectives. The Board believes that governmental fund financial statements applying the short-term financial resources measurement focus and accrual basis of accounting (a) assist in fulfilling a government's duty to be publicly accountable and enable users to assess that accountability (fiscal accountability), (b) assist with demonstrating whether resources were obtained and used in accordance with the entity's legally adopted budget, and most importantly, (c) provide information about sources and uses of financial resources. The governmental fund financial statements are the only source for information about sources and uses of financial resources. The Board also believes that the short-term financial resources measurement focus and accrual basis of accounting, in conjunction with the government-wide financial statements, provides information to determine whether current-year revenues were sufficient to pay for current-year services and whether the government's financial position improved or deteriorated as a result of the year's operations. Additional information about current-year revenues and costs of current-year services, as well as financial position from a longer term perspective, is provided by the government-wide financial statements.

### ***Applicability to a Reporting Period***

B32. Applicability to a reporting period is used to determine whether a flow of resources is recognized as an inflow of resources or an outflow of resources or as a deferred inflow of resources or a deferred outflow of resources in accordance with the definitions of elements of financial statements in Concepts Statement 4. In assessing applicability to a reporting period for flows recognized using the short-term financial resources measurement focus and accrual basis of accounting, the Board noted that financial items arising from short-term transactions and other events are the same as financial items arising under the economic resources measurement focus and accrual basis of accounting. Therefore, extending the use of the concept of interperiod equity in determining applicability to a reporting period is appropriate. For items arising from long-term transactions and other events, the Board noted that it is unnecessary to assess applicability to a reporting period for those items because they are recognized when payments are due. However, in certain circumstances in which financial resources are received in advance of the underlying transaction, determination of the applicability to a reporting period is needed. The Board determined that through the application of the accrual basis of accounting from a conceptual perspective, the applicability of flows to a reporting period should not be different from the underlying transaction, for which applicability to the period should be determined using the concept of interperiod equity.

### **Hierarchy of Recognition**

B33. In the development of Statement No. 65, *Items Previously Reported as Assets and Liabilities*, the Board found that certain items arising from a transaction or other event may meet the definition of more than one element. The Board believes that the hierarchy for elements of financial statements should be part of the conceptual framework to promote consistency in the application of the definitions of elements of financial statements.

### **Considerations Related to Benefits and Costs for This Concepts Statement**

B34. The overall objective of financial reporting by state and local governments is to provide information to assist users (the citizenry, legislative and oversight bodies, and investors and creditors) in assessing the accountability of governments and in making economic, social, and political decisions. One of the principles guiding the Board's setting of standards for financial reporting is the assessment of the expected benefits and perceived costs.

B35. Present and potential users are the primary beneficiaries of improvements in financial reporting. Persons within governments who are responsible for keeping accounting records and preparing financial statements, as well as managers of public services, also benefit from the information that is collected and reported in accordance with GASB standards. The costs to implement the standards are borne primarily by governments and, by extension, their citizens and taxpayers. Users also incur costs associated with the time and effort required to obtain and analyze new information to meaningfully inform their assessments and decisions.

B36. The Board's assessment of the expected benefits and perceived costs of issuing new standards is unavoidably more qualitative than quantitative because no reliable and objective method has been identified for quantifying the value of improved information in financial statements. Furthermore, that assessment is directly relevant to an authoritative pronouncement. On the other hand, the evaluation of expected benefits and perceived costs in a nonauthoritative Concepts Statement is indirect because concepts do not establish specific accounting standards; they provide general principles to be applied in the standards-setting process. The fact that an analysis of expected benefits and perceived costs of concepts is general in nature and one level removed from that normally subjective assessment makes its conclusion even more subjective. Nonetheless, the Board undertakes the assessment based on the available evidence regarding expected benefits and perceived costs with the objective of achieving an appropriate balance between maximizing benefits and minimizing costs.

B37. The Board concluded that these concepts will benefit users because they will (a) better understand the reasoning underlying accounting and financial reporting standards and (b) benefit from information in financial statements that is more consistently reported as a result of the Board's use of these concepts in future standards setting. These concepts will benefit preparers and auditors as well because they also will better understand the reasoning underlying accounting and financial reporting standards. Additionally, preparers and auditors will benefit by having additional guidance to consider when assessing recognition issues for transactions for which authoritative standards have not been issued.

B38. The recognition concepts for both the economic resources measurement focus and accrual basis of accounting and the short-term financial resources measurement focus and accrual basis of accounting address cost considerations. Included in both is consideration of the limitations of financial reporting in Concepts Statement 1. Paragraph 73 of that Concepts Statement discusses the limitation of the costs of providing information and the need for the Board to consider cost-benefit relationships in standards setting.

### **Alternative View**

B39. One Board member expresses an alternative view to this Concepts Statement for three primary reasons:

- The Concepts Statement continues the movement of governmental fund accounting and reporting away from budgetary accounting and reporting.
- Owing to a serious conceptual flaw, it facilitates no significant operational decisions or evaluative judgments.
- It fails to address the most significant limitations of the current financial accounting and reporting model.

### **Moving Fund Accounting Further from Budgetary Accounting**

B40. The Board member that expresses the alternative view objects to this Concepts Statement because it further severs governmental fund accounting and reporting from their

budgetary counterparts. In that member’s opinion, it thereby undermines the very rationale for the presentation of governmental fund financial statements.

B41. The importance of linking a government’s financial statements to its legally adopted budget has long been recognized. NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, issued in 1979, stated that “ideally, the basis upon which the budget is prepared should be consistent with the basis of accounting utilized. . . .”<sup>1</sup> It also promulgated a current financial resources measurement focus and a modified accrual basis of accounting that were similar, if not necessarily identical, to those of the governmental fund budgets of most state and local governments.<sup>2</sup>

B42. The GASB, in Concepts Statement No. 1, *Objectives of Financial Reporting*, issued in 1987, recognized that “many believe the budget is the most significant financial document produced by a governmental entity.”<sup>3</sup> Affirming the primacy of the budget, it established the following as an objective of financial reporting:

*Financial reporting should demonstrate whether financial resources were obtained and used in accordance with the entity’s legally adopted budget; it should also demonstrate compliance with other finance-related legal or contractual requirements.*<sup>4</sup> [Original footnote reference omitted.]

B43. Then, in 1999, Statement 34 operationalized that objective by prescribing a continuation of the current financial resources measurement focus and modified accrual basis of accounting. The Board observed that there might be virtue in requiring that each government prepare its governmental fund financial statements on its own unique budgetary basis (in many cases a near-cash basis) rather than a common basis. However, in the absence of uniform standards for budgets, it contended in Statement 34 that such a directive would diminish comparability among governments.<sup>5</sup> Nevertheless, the Board emphasized that the focus on current financial resources is intended to maintain the close ties between budgeting and financial reporting.<sup>6</sup>

B44. Financial statement users have consistently voiced support for a budget-oriented measurement focus and basis of accounting. In Statement 34, the Board supported its current financial resources model by citing its own research studies of 1985 and 1990, various independent academic studies, and respondents’ comments to several of its due process documents.<sup>7</sup>

B45. The GASB asserted in Concepts Statement 1 that financial reporting should not only demonstrate budgetary compliance but also should indicate the extent to which interperiod

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<sup>1</sup>Paragraph 78

<sup>2</sup>Paragraph 87

<sup>3</sup>Paragraph 19

<sup>4</sup>Paragraph 77(b)

<sup>5</sup>Paragraph 252

<sup>6</sup>Paragraphs 237–238

<sup>7</sup>Paragraph 212

equity has been achieved. That is, “financial reporting should provide information to determine whether current-year revenues were sufficient to pay for current-year services.”<sup>8</sup> This objective, however, can be realized only with financial statements that take a long-term recognition approach. As addressed in a subsequent section of this alternative view, persuasive arguments can be made that governmental fund financial statements should be reported using a full accrual basis of accounting, or some comparable basis, that encompasses noncurrent, as well as current, resources.

B46. The short-term financial resources measurement focus and accrual basis of accounting is, in essence, a compromise between a budget-based model that focuses on a narrow range of resources and a full-accrual model that focuses on a broad range of resources. As such, it fulfills neither of Concepts Statement 1’s salient objectives. It neither demonstrates budgetary compliance nor provides information as to whether current-year revenues were sufficient to pay for current-year services. Accordingly, despite claims of its proponents, the short-term financial resources measurement focus and accrual basis of accounting is inconsistent with the reporting objectives that the Board itself has established.

### **Facilitates No Significant Operational Decisions or Evaluative Judgments**

B47. The Board member that expresses the alternative view believes that a serious conceptual flaw renders the short-term financial resources measurement focus and accrual basis of accounting information devoid of decision utility.

B48. The short-term recognition approach for governmental fund financial statements distinguishes between short-term and long-term assets and liabilities based on the date of the *inception* of the underlying transaction or other event. Thus, only assets and liabilities that had an *initial* maturity of one year or less would be reported in governmental fund balance sheets; those with an initial maturity of more than one year, even if due one day after the balance sheet date, would be reported only in government-wide statements of net position. The length of time until maturity as of the balance-sheet date would not be taken into account.

B49. Consider a stylized example that highlights the shortcomings of this approach according to the Board member that expresses the alternative view. Two governments are exactly the same in all respects except that one issued a \$10 million, one-year note in January 20X5; the other issued a five-year, \$10 million note four years earlier in January 20X1. Both notes are due in January 20X6. As of the balance sheet date of December 31, 20X5, both governments are in exactly the same economic position. Both have an obligation of \$10 million due in January 20X6. Hence, for both governments, the obligations are due in the short term. Yet, ignoring any other assets and liabilities, the government with the one-year note would report a liability \$10 million greater and a fund balance \$10 million less than the government with the five-year note.

B50. It is a widely accepted principle of both management accounting and financial economics that sunk costs are irrelevant for decision making. The date that a transaction

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<sup>8</sup>Paragraph 77(a)

was initiated is the equivalent of a sunk cost. It matters not when a financial obligation or receivable arose; when it arose is past history and thereby irrelevant. What is relevant is the amount and timing of cash flows—the amount of the obligation or receivable and the date on which the obligation is required to be paid or on which the receivable can be collected.

B51. As is evident from the example, the balance sheet produced from applying the short-term financial resources measurement focus and accrual basis of accounting could not be relied upon to indicate the amount that is available for spending in the short term. Yet this is the amount that is most relevant to governmental managers, legislative bodies, bond rating agencies, investors, and citizens. In fact, as a consequence, the Board member that expresses the alternative view has been unable to identify a single significant decision that the resultant balance sheet can be used to facilitate.

B52. Governmental fund financial statements are not intended to be the sole source of information indicative of a government’s fiscal status. For information on long-term resources, users need to look to the government-wide financial statements, notes, and supplementary disclosures. However, while governmental fund financial statements cannot be expected to provide complete information, neither can they be permitted to mislead users of those financial statements. But if the short-term financial resources approach is taken, mislead they will. The Board’s Basis for Conclusions purports that “financial statements presented applying the short-term financial resources measurement focus and accrual basis of accounting enable assessment of the amount of fund balance at period-end. . . .”<sup>9</sup> Unfortunately, they do no such thing. They do not enable the assessment of fund balance legally available for appropriation or fund balance available for spending.

B53. The Board member that expresses the alternative view believes that an accounting and reporting model that is at best decision useless, and at worst misleading, is indefensible.

### **Fails to Address the Most Significant Limitations of the Current Financial Accounting and Reporting Model**

B54. The Board member that expresses the alternative view believes that the short-term financial resources measurement focus and accrual basis of accounting fails to address the most pressing drawbacks of the presently employed GASB model: it promotes a short-term fiscal-policy perspective.

B55. Anecdotal and empirical evidence indicate that both government managers and legislators look to governmental funds—primarily the general fund—to inform fiscal decisions. However, because the governmental fund financial statements of the general fund exclude long-term obligations, the Board member that expresses the alternative view believes they obfuscate the government’s true financial condition. They conceal costs and obligations incurred in a current period that will not have to be budgeted for, or reported on, until a future period. For obvious reasons, these budgeting and reporting practices promote policies that transfer fiscal burdens from the present to the future. The

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<sup>9</sup>Paragraph B25

consequences are most clearly manifest in the failure of many governments to adequately fund their pension and OPEB plans.

### ***A Possible Alternative Approach That Would Provide Both Budgetary and Long-Term Information***

B56. As emphasized above, the Board member that expresses the alternative view recognizes the importance of providing *both* budget-based and long-term information in governmental fund financial statements. The Board member that expresses the alternative view does not believe, contrary to what has been implied in the Board's previously issued Preliminary Views document related to this project, that the Board has to choose between a budgetary and a long-term approach. The Board member that expresses the alternative view believes instead that both approaches can be taken within the same set of governmental fund financial statements.

B57. The Board member that expresses the alternative view believes that the Board should be considering for the general fund (the general fund being the one that is of paramount concern to users), as but one possibility among several, a measurement focus and basis of accounting that would result in a layered statement of activities and a columnar balance sheet. The statement of activities would have three layers. The top layer would report inflows of resources and outflows of resources on the government's own unique budget basis. These inflows of resources and outflows of resources, when added to the beginning-of-year budgetary fund balance, would result in a "bottom line" indicative of end-of-year budgetary fund balance.

B58. The second layer would be on a standardized basis—a "modified accrual" basis of accounting. This layer, similar to the current financial resources measurement focus and modified accrual basis of accounting, would be governed by specific standards established by the GASB and would be on a "budget-like" basis. As discussed previously, to be of value to users having to compare governments, a model needs to be structured around uniform standards. In this layer, any inflows of resources and outflows of resources that would be recognized under the standardized basis, but not the government's own budgetary basis, would be added to, or subtracted from, the fund balance of the previous layer. For example, suppose a government were on a near-cash basis for budgeting purposes and thereby recognized property taxes as revenue only as collected. GASB standards, however, might specify that property taxes collected within 60 days after the close of the year also would be recognized. The additional taxes to be collected within the 60-day period would be added to the previous layer's fund balance and thereby incorporated in the fund balance to be reported in this second layer.

B59. The third layer would be on a "full accrual" basis of accounting, albeit one excluding some capital assets and related liabilities. The assets focused upon would include long-term financial assets as well as equipment and similar capital assets that were purchased with general fund resources. They would exclude infrastructure and other capital assets acquired with bonds and comparable long-term obligations. The liabilities would include all obligations except for the debt and comparable obligations related to the excluded assets. This third layer would incorporate any adjustments to the previous fund balance required to

transform the statement from the modified accrual basis of accounting to the full accrual basis of accounting. These would include, for example, property taxes expected to be collected outside of the 60-day window, pension and OPEB expenses that exceeded contributions, and the various modifications associated with relevant capital assets and related long-term borrowings.

B60. The balance sheet would consist of three columns—one for each of the three bases. Each would report the total assets and liabilities recognized on the particular basis. Thus, consistent with the previous example, the budget (near-cash) basis column on the balance sheet would report zero property taxes receivable; the modified accrual basis of accounting column would report taxes receivable collected within 60 days; the full accrual basis column would report all taxes receivable.

B61. The Board member that expresses the alternative view acknowledges that for this proposal to be put into practice, there would be details that would need to be worked out and implementation standards and guidance that would need to be issued. However, the Board member that expresses the alternative view is confident that both the statement of activities and the balance sheet could be formatted and presented in ways that are readily understandable to the audiences to whom the financial statements are targeted. Moreover, the Board member that expresses the alternative view believes that this approach would not require governments to report any information that is not already incorporated in their budgets, their existing governmental fund financial statements, or their government-wide financial statements. Thus, the Board member that expresses the alternative view believes that few, if any, modifications to existing accounting systems would be required. While, as with any new model, governments would likely incur additional financial statement-preparation costs in the first year of implementation, the Board member that expresses the alternative view anticipates that they would not be significant.

***Better to Take a More Limited Approach to Remediating the Current Model's Flaws Than to Adopt an Equally or More Seriously Flawed Model***

B62. The Board member that expresses the alternative view concedes that there are both conceptual flaws in the current model as well as inconsistencies in how it is applied. For example, long-term receivables are recognized, whereas long-term liabilities are not. Similarly, some governments apply a 60-day criterion as to when resources other than property taxes become available for expenditure while others apply a longer or shorter period. These flaws, however, can be remedied with straightforward adjustments to the model. Long-term receivables can be removed from the model and a uniform recognition period can be established for all revenues, not just as it is now for property taxes.

B63. The Board member that expresses the alternative view believes that the Board would better serve the interests of its stakeholders by fine-tuning the current model than by introducing a new model that fails to address the current model's underlying defects. If the past is a guide to the future, the life expectancy of the model will be at least 25 years, thereby preventing major but desirable reforms for at least another generation.

B64. In summary, the Board member that expresses the alternative view sees few, if any, benefits to the short-term financial resources measurement focus model. The model not only loosens the ties between the financial statements and their traditional budgetary moorings, but owing to how it distinguishes between long-term and short-term resources, it is conceptually flawed. As a consequence, it is likely to undermine, rather than inform, user decisions. Furthermore, it fails to address the most acute deficiencies of the present model. Simply stated, its costs outweigh its benefits.

## Appendix C

### CODIFICATION INSTRUCTIONS

#### ***Codification of Governmental Accounting and Financial Reporting Standards—June 2021 Update***

C1. The instructions that follow update the December 31, 2019 *Codification of Governmental Accounting and Financial Reporting Standards* (Codification) for the provisions of this Concepts Statement. Only the paragraph number of the Concepts Statement is listed if the paragraph will be cited in full in the Codification.

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### GASB CONCEPTS STATEMENTS

### APPENDIX B

#### **Concepts Statement No. 4**

[Revise the introductory paragraph as follows:]

In June 2007, the GASB issued Concepts Statement No. 4, *Elements of Financial Statements*. The Concepts Statement subsequently was amended by Concepts Statement No. XX, *Recognition of Elements of Financial Statements*, in Month YYYY. Because Concepts Statements are not authoritative, this Concepts Statement has not been integrated into the Codification but instead has been reproduced here (without appendices), as amended.

27. [Replace the sixth sentence with GASBCS XX, ¶12.] [GASBCS 4, ¶27, as amended by GASBCS XX, ¶12]

39. [In the fourth and seventh sentences, replace *current* with *short-term*; in the penultimate sentence, replace *expenditure, other financing use* with *outflow of short-term financial resources* and replace *other financing use* with *inflows of short-term financial resources*.] [GASBCS 4, ¶39, as amended by GASBCS XX, ¶9–¶11]

[Add to Appendix B as follows:]

#### **Concepts Statement No. XX**

In Month YYYY, the GASB issued Concepts Statement No. XX, *Recognition of Elements of Financial Statements*. Because Concepts Statements are not a source of

established accounting principles, this Concepts Statement has not been integrated into the Codification but instead has been reproduced here (without appendices).

[Insert GASBCS XX, Summary, Table of Contents, and ¶1–¶13, including headings.]