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GASB 34: WHAT IT MEANS FOR YOU

GASB 34, the new financial reporting model of the Governmental Accounting Standards Board (GASB), has the potential to change the way citizens evaluate their officials' performance and how the financial community assesses government credit. In addition to reporting on fund types with diffferent measures of performance, local governments will now report on the government as a whole, with a focus on the cost of delivering services.

GASB believes financial statements prepared in compliance with the new rules will be easier to read, more useful to a broader spectrum of users, and more helpful to local government managers. The usefulness of the financial statements will be determined by the quality of information, the comparability of valuation, and the way transactions have been tracked in the past.

This report looks at GASB 34 from three vantage points: a director of finance in a local government, a rating agency, and a government official in a jurisdiction that has already implemented GASB 34.

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What City Officials Need to Know about GASB's New Reporting Model

The author of this section is Robert V. Stout, certified public accountant and director of finance for Modesto, California. In addition to having been a chief finance officer in five states, he served as one of the original project managers for the Governmental Accounting Standards Board (GASB) and has also been a member of the Governmental Accounting Standards Advisory Council (GASAC), the body that oversees and advises the GASB. Mr. Stout is also a twenty-year member of the Government Finance Officers Association (GFOA).

GASB 34 is the new financial reporting model of the Governmental Accounting Standards Board (GASB). This model is the most significant change to date in the way governments report their financial positions and the results of the year's activity. Most important—for those who do not have accounting degrees—the new model has the potential to change forever the way citizens evaluate how their elected and appointed officials have performed and how the financial community assesses government credits.

Hyperbole? At this point, it is hard to say. But the potential impact of this revolutionary (or evolutionary, as the GASB prefers) approach to looking at government operations means that everyone involved in managing any part of a local government needs to have a basic understanding of this new model.

WHAT IS THE GASB?

Before any explanation of the new model can be really understood, it is important to understand what GASB is, who its members are, and why it has the power over local governments to make such a fundamental change in their financial reporting. GASB was created in 1984 to replace the National Council on Governmental Accounting. Its mission is to determine generally accepted accounting principles for state and local governments. Its board consists of seven members, each of whom has many years of experience with state or local government finances or reporting. GASB has been working on the project that resulted in GASB 34 for more than 15 years.

COMPARING APPLES WITH APPLES

When a government hires an outside accounting firm to audit its financial statements, what it is primarily paying for is the auditor's opinion of whether the financial statements fairly present the results of operations in accordance with generally accepted accounting principles. To potential investors (those who might buy a government's bonds, for example), this is a very important point. Investors read a city's financial statement to help decide whether City A's bonds are a better investment (that is to say, have lower financial risk) than City B's bonds. It is only when investors see that both cities are preparing financial statements in accordance with generally accepted accounting principles that investors know they are comparing apples with apples.

> **Generally accepted accounting principles make it possible to provide comparable measures of the government's results.**

If a city or county is planning on issuing debt, generally accepted accounting principles are very important. They make it possible to provide comparable measures of the government's results for the year. Even if a city is not issuing debt, generally accepted accounting principles provide more comparable measures of the government's results for the year.

CHANGING GOVERNMENT FINANCIAL STATEMENTS

In June 1999, GASB issued its Statement No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments," which significantly changes the way in the which local governments report their finances:

- Emphasizing the government as a whole rather than just fund types and fund information

- Changing how governments measure what they do
- Requiring the reporting of infrastructure and its general depreciation.

MAKING GOVERNMENT FINANCIAL STATEMENTS EASIER TO UNDERSTAND

The change that will immediately strike even the most cursory reader of statements prepared under the requirements of Statement No. 34 is the addition of reporting on the government as a whole rather than only a collection of funds and fund types. A common complaint of readers of government financial statements—especially readers with experience reading or using financial statements prepared by the private sector—is confusion caused by the multiple columns for each of the different fund types used by governments. A balance sheet following the rules in effect before GASB 34 could have ten or more columns. A reader trying to see the operating results of the government would be confronted with three different operating statements: two for the governmental funds and another for what governments call their business-type activities.

GASB has attempted to end this confusion by adding government-wide reporting. Statement No. 34 requires consolidated government-wide statements with a single Statement of Net Assets and a single Statement of Activities.

The objective of the Statement of Net Assets is to help readers easily evaluate the financial condition of the complete government entity. For the first time, it will be easy to see whether a specific government is better off at the end of the year than it was at the beginning.

The new Statement of Activities can only be called breathtaking in its scope. It attempts to show not only whether the government's revenues were sufficient to pay for the services it delivered during the year, but also the gross and net economic costs of each of its major functions or activities. Legislators and citizens will be able to see how much of a subsidy each government activity actually requires.

Measuring the cost–benefit relationships of government activities has been difficult in the past. In the future, although the assessment of the benefits of an activity will still require subjective judgments, the cost side of the equation will be more readily available to all interested parties because of the accounting reforms announced by GASB.

CHANGING HOW GOVERNMENT MEASURES FINANCIAL PERFORMANCE

State and local governments have been using two completely different ways of measuring their performances during their fiscal years. One measure is used for general governmental functions such as providing public safety; another measure is used for governmental utilities such as water or electricity. In the general fund, governments report on how much was spent to deliver a service. But for local government's business-type activities, such as the water utility, governments keep track of the economic cost of delivering a service. These are two entirely different accounting concepts.

More important, the differences between the two—in dollars—can be significant. For example, if the government buys a $20,000 vehicle for the police department with general—fund resources, the entire price of that new vehicle is shown as spent during the year. However, in the utility fund, the price of that same vehicle is depreciated over its useful life. If it is assumed that the vehicle will last five years, the utility would recognize only $4,000, one-fifth of the price, as the economic cost of that vehicle for each of the next five years. Accountants call this a difference in measurement focus, and it is simply not possible to meaningfully add together activities that make use of the two different measurements.

> **The change is the reporting on the government as a whole instead of a collection of funds and fund types.**

These differences have evolved for good reason. For local government, the objective is to show how the citizens' taxes are spent and that the money was spent in accordance with the legally adopted budget. For utilities, the objective is to show that the utility rates are generating enough revenue to cover the economic costs of operating the utility. Money spent (the general fund) has a short-term focus, while economic cost (the utility fund) has a long-term focus.

In Statement No. 34, GASB solved this problem by asserting that both types of information are needed. Although the new rule will allow the traditional spending focus to be retained when reporting on funds, it requires new government-wide statements to focus on economic cost.

To convert governmental activities to an economic cost format, information must be added to the governmental funds in much the same way that information is added to budgetary accounts to comply with today's standards. Although this will consume time and money, investors, legislators, and citizens for the first time will be able to see the economic cost of each major service their government is providing.

Budget-to-actual cost information, prepared with the traditional spending focus, will still be required for the general fund and special revenue funds; therefore, both types of information will be available. GASB believes that both types of information are needed to understand fully how government functions and make informed decisions. To alleviate any confusion that could result from the inclusion of different ways of measuring operations, GASB requires that the different sets of information be reconciled.

INFRASTRUCTURE AND DEPRECIATION

Perhaps the most controversial component of the new GASB statement involves infrastructure and is the direct result of the shift from resources spent to economic cost. The term infrastructure normally means those assets that are immovable (including, for example, sidewalks, roads, bridges, and storm drains). Governments traditionally have not been required to report on the infrastructure of the general government although some governments have done so voluntarily. But GASB has decided that infrastructure should be capitalized and generally depreciated over its useful life because one of the most significant costs of providing government services is related to infrastructure, and GASB is seeking consistency with the concept of economic cost of services.

> **Perhaps the most controversial component of the new GASB statement involves infrastructure.**

Some governments may find it expensive to determine retroactively the value of their infrastructure. Perhaps more important, however, is a fundamental disagreement over the value of the information itself. The Government Finance Officers Association (GFOA) has strongly opposed the requirement of recording and depreciating infrastructure. Some of its members disagree with GFOA's opposition, but GFOA believes not only that the cost of such information is not worth the benefit but also that the requirements "fail to provide information of any practical value to governments, citizens or investors," according to GFOA's executive director. GFOA does not believe that knowing one-thirtieth of the cost of paving one mile of road in 1981 will help legislators decide how much to spend on highway maintenance in fiscal year 2000. In contrast, however, the new requirements have been applauded by such organizations as the National Federation of Municipal Analysts; the Bond Market Association; the National Association of State Auditors, Controllers and Treasurers; and various citizen groups.

To address at least some of the concerns raised by government finance officers, GASB has

- Allowed certain estimation techniques to help reduce the cost of compliance
- Extended the effective date for the retroactive application of the infrastructure provision by an additional four years for large- and medium-size governments
- Eliminated the potentially costly retroactive provision for small governments.

WHEN WILL THIS HAPPEN?

For governments with more than $100 million in total revenues, the Statement 34 requirements will become effective for financial statements for fiscal year 2002. Smaller governments have been given an extra year or more. Various accounting associations and public and private organizations are working to help local government and state officials and staff understand and prepare for these new requirements.

SUMMARY

It is a significant governmental shift from reporting only fund types with different measures of performance to reporting on the government as a whole with a focus on the cost of delivering services is significant.

As with all major changes, this one has not been without controversy. One benefit is that readers of government financial statements will have much more information on which to evaluate the performance and stewardship of their elected and appointed government officials.

GASB believes that the GASB 34–compliant financial statements will be more widely read and that the information in them will be more useful to a broader spectrum of users than the information as presented in current statements. GASB also believes that the emphasis on economic cost of service will help everyone who is involved in managing state and local governments to make more efficient and effective use of taxpayer dollars.

GASB 34: What Implementation Means to the Rating Process

The authors of this section are Hyman C. Grossman, LaVerne Thomas, and Diane P. Brosen; all are with Standard & Poor's. Mr. Grossman has been with S&P since 1963, speaks regularly before regional and national groups concerned with municipal finance, and has written extensively on the subject. Ms. Thomas has 14 years of experience in government finance in states and counties, and for S&P she analyzes tax-backed and utility credits. She represented S&P at GASB's Measurement Focus Basis of Accounting forum. Ms. Brosen specializes in analysis of short-term debt instruments and is S&P's senior spokesperson on credit ratings for many East Coast states as well as California. This section combines two separate S&P pieces: "GASB 34: What Implementation Means to the Rating Process" and "Governments Weigh In on GASB 34."

The Government Accounting Standards Board (GASB) Statement No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments," will significantly change the way governments report their finances to the public.

Adopted unanimously on June 10, 1999, following a 10-year process, Statement 34 evolved from the GASB's "Objectives of Financial Reporting," which guides financial disclosure in a government's comprehensive annual financial report. Statement 34 will greatly expand the information available to financial-statement users and may initially increase the cost a government incurs to modify its financial-reporting system.

GASB 34 will significantly change the way governments report their finances to the public.

The implementation of Statement 34 represents a major change in financial reporting in that it introduces full accrual of governmental resources and obligations. This method of reporting represents a significant, challenging undertaking. The ease and effectiveness of implementation will vary among entities, with the key determinants of ease being the quality of asset and infrastructure information currently maintained by an entity and the amount of system modification that will be needed.

The use of estimates to quantify resources and obligations will be greatly expanded, and new information will become available about programs that was not readily available previously. A documented trend of results will become part of audited financial reports. Where debt is associated with a program and revenue and expenditures are discretely displayed, the new information will be useful in determining compliance with legal covenants.

Statement 34 applies to state and local governments, public school districts, and government-owned hospitals and universities.

STATEMENT OF NET ASSETS

The Statement of Net Assets will report all of a government's assets, including infrastructure, liabilities, and the difference between these two amounts as net assets. The counterpart financial statement is the Statement of Activities, which reports all revenues, expenditures, and the change in net assets. Both statements will use the (full) accrual basis of accounting, a major shift from the modified basis of accounting previously used for reporting current operations and still used for basic financial statements. All funds will be summarized and reported, with the exception of fiduciary funds or those used to report resources held by the government on behalf of others, like pension funds. Current fund operations will be reported in what is now termed the basic financial statements covered later in this commentary.

The Statement of Net Assets will present all of a government's assets less its long-term liabilities. This practice is a major change to having assets and long-term liabilities reported in "groups of accounts" that had no effect on the former calculation of fund balance. The Statement of Net Assets brings a new set of facts into the rating analysis.

The quality of the assets, including newly quantified infrastructure, will determine the usefulness of the net-assets figure. Because liabilities are often tied to legal documents and payments to bondholders, quantifying a government's liabilities is more precise than quantifying its assets. After the government finances all long-term liabilities, the statement will show the change in net assets summed for all governmental and enterprise funds. Net assets will be categorized as "non-restricted," "invested in capital assets," "net of related debt," and "restricted."

Although it will be useful to look at the change in net assets from year to year, it will be difficult to project the availability of net assets for succeeding fiscal periods. To make tighter assessments about future net resources, analysts still will have to rely on the basic financial statements and adopted or planned budgets. As conformity is established in reporting long-term assets and liabilities and revenues and expenditures, the information will be much more useful to the rating process, and particularly the analysis of trends. As trends develop and are validated, new statistics based on the long-term view will become a formal part of the rating process.

An analyst must have confidence in the estimates used to value infrastructure.

The change in net assets, however, will show whether the government is acquiring assets to benefit future fiscal years or if these assets are being used but not replaced. For example, if a class of capital assets is not being maintained at a certain condition and depreciation is recorded, this class of assets will decrease and so will net assets, assuming that liabilities are unchanged. On the other hand, if liabilities are decreasing more slowly than the value of assets is increasing, the value of "net assets" will decrease. The changes reflect government's choices and policies, most often in response to changing economic conditions; and analysts can make inferences about these choices.

To have any meaningful comparisons involving infrastructure, an analyst must have confidence in the estimates used to value infrastructure. It is expected that variations in estimation techniques based on which method is used to value infrastructure will occur. However, if wide variances result, comparability between municipalities or other governmental issuers will be far less useful.

GASB gives the option of using either historical or modified approach similar to deflated current replacement cost estimates. When historical records are not readily available, governments might choose the modified approach. But, depending on the choice and how the estimates are used, material variations could result, at least initially. If such a case were to arise during the rating analysis, Standard & Poor's would rely on management to explain choices and the policy they adopted to guide valuation.

Major changes caused by Statement 34

- Governments will report the results of government-wide operations in two new reports: the Statement of Net Assets and the Statement of Activities
- Infrastructure will now be quantified and reported in the Statement of Net Assets
- Infrastructure, fixed assets, and long-term liabilities will be brought into the calculation of net assets (a long-term concept similar to fund balance)
- Governments will depreciate infrastructure or use a valuation method that produces estimates closer to current values
- Operating results will be reported for the general fund and newly defined major funds
- Reporting on the operations of major programs will be highlighted
- Management discussion of two-year trends, major achievements or challenges, and significant changes are required in the Management Discussion and Analysis.

STATEMENT OF ACTIVITIES

The Statement of Activities sums all revenue and expenditures for all funds except fiduciary funds, and the difference equals the net change on the Statement of Net Assets. Here again, the usefulness of the change is based on the quality of the revenue and expenditure accrual. Since the (full) accrual method is being used for the long-term statements, all revenue, regardless of when it will be received, will be recorded. All expenditures will be recorded, regardless of whether paid. Thus, if unpaid expenditures are increasing at a faster rate than expected revenue, the change in net assets will be negative and could signal impending fiscal stress.

Under the tenets of GASB 34 and GASB 31, a government can incur a gain or a loss for various reasons that now must be reported on the government-wide Statement of Activities. Previously, gains and losses were most commonly seen in the enterprise statements. Now, gains and losses for reasons in addition to those related to investment transactions will affect the change in net assets. Like other net-asset changes, gains and losses will point to how well government managers are handling stewardship responsibilities.

The proposed format for the Statement of Activities is very different from the presentation in the Statement of Revenues, Expenditures, and Changes in General Fund Balance. A new concept reported is program expenditures less the revenue, such as grants, related to programs. The difference between program expenditures and revenue is classified into governmental and business-like activities. General revenues are added to the net program results to obtain the net change in assets. Simply put, the calculation now becomes:

- Total expenditures minus program revenue equals net governmental or business-like activities;
- Net governmental or business-like activities minus general revenue equals net change in assets.

The benefit from analyzing the Statement of Activities is to see readily what proportion of expenditures is financed with direct program revenues, general revenue such as property taxes, or user fees. This in turn shows the net cost of all government services that are passed along to taxpayers and the net costs financed by user fees.

Over time, trends in average net cost data across different sectors of government might be useful in quantifying the cost of delivering government services. At the least, the new reporting format shows, at a general level, the amount of property tax revenue that subsidizes certain functions of government. Under the old (pre-GASB 34) reporting structure, a health and welfare program might have expenditures in both the general and special revenue funds. Tax revenue or grants for the program would be separately reported in both funds. Now, with the combined fund reporting, operations for the total program spending would be presented. As trends develop, the rating analysis could include a review of the percentage of program cost financed by program, general, or business-like revenue compared across a broad spectrum of issuers like cities, for example. Of course, state legislation governing the types of taxing and fee-generating authority a municipality has will cause differences between states.

The benefit of the Statement of Activities is the ability to see what proportion of expenditures is financed with direct program revenues, general revenue, or user fees.

Another useful comparison is debt service as a percentage of the available fund expenditures and whether the percentage is high, moderate, or low. As with any statistic, it must be reviewed within the context of a broad array of statistics and rating factors. Another statistic that could enhance the review of an issuer's capital program is the cost per capita of the investment in infrastructure over a period of time such as the duration of a capital plan.

MAJOR FUNDS: THE BASIC FINANCIAL STATEMENTS

This section of the financial reporting model will be familiar to users. The old concept of general, special, debt service, and enterprise funds is reported in this section of the financial statements. Fiduciary funds are separately reported and the modified accrual basis is used except for reporting the operations of enterprise funds. Governments can elect to use the statement of revenues, expenditures, and net change in fund balance if they desire to do so. However, GASB encourages the format used in the Statement of Activities, except that the information would be reported for each major fund (general, special, debt, capital funds). The rating analysis would continue to incorporate what has been used in the past. Some of the factors frequently reviewed are:

- General and debt service fund revenue, expenditures, and reserves
- Changes in debt service expenditures
- Changes in cash balances and short-term borrowing trends
- Dedicated revenue for debt service, debt service coverage and changes in coverage
- Changes in rates charged for governmental services such as provided by utilities
- Expenditures on capital
- Contingency reserves.

Regardless of the format adopted, Standard & Poor's will still need to collect at a minimum financial information, used with other data, it has traditionally used in assigning a rating. The reconciliation required by GASB will be an important first step in moving between the current view and the long-term view of a government's financial report. However, because of the complexity, managers should be prepared to discuss how the newly reported information ties to the reports prepared under the old model.

Table 1: Statement 34 Implementation Dates for States and Local Governments

	Annual Revenues	Implementation Date
Large	$100 million or more	Beginning after June 30, 2002
Medium	$10 million but less than $100 million	Beginning after June 30, 2003
Small	Less than $10 million	Beginning after June 30, 2004

Table 2: Comparison of Major Accounting Changes

	Former	New (Statement 34)	Statement Location
Infrastructure Reporting (State and Local Governments)	Fixed Asset Group of Accounts	Infrastructure included as an asset and will affect the calculation of net assets	Statement of net assets
Long-term debt for General and other governmental Funds (state and local governments)	Long-term debt group of accounts—usually not matched to asset	Included as a long term liability and will affect the calculation of net assets	Statement of net assets
Management discussion and analysis	Not required	Required	Precedes financial statements
Enterprise operations such as utilities	Required using full accrual	Required using full accrual	Basic financial statements
Depreciation on infrastructure	Not required	Required if infrastructure is not maintained according to guidelines	Statement of activities
Debt service on long-term debt	Required	Required	Statement of activities (infrastructure related) and depending on source of payment, general or debt service or other basic financial statement
General fund and other current funds	Required	Required	Basic financial statements
Revenue and expenditure analysis for major funds	Not required	Required	Major funds reported with basic financial statements

Budget to Actual Reporting

Budgetary reporting will be enhanced by including the original budget along with the revised and adopted budgets, compared with actual results. The rating process has always included a look at current and future budgets, and changes in this area have no impact.

Management Discussion and Analysis (MD&A)

This summary analysis is very helpful in guiding readers through what is presented in the remainder of the report and is a welcome addition. In particular, an assessment by management discusses whether financial operations have improved or deteriorated during the reporting period. The MD&A ties together financial information in much the same way as businesses now report. A fuller discussion of major variances is encouraged as well as what has been invested in capital assets and changes in long-term debt.

IMPLEMENTATION

Implementation planning has begun for most governments. A large government with a fiscal year ending June 30 will need to begin implementing the statement in 2001 for fiscal year June 30, 2002. The remaining two phases of implementation would begin in 2002 (for entities with revenue of at least $10 million but less than $100 million) or 2003 for all others. The necessary level and extent of planning is dependent on the above information and system needs.

To assess the impact on governmental entities of preparation and implementation, Standard & Poor's has surveyed a representative sample of governmental entities across the United States on GASB 34's impact. As survey results have begun to accumulate, certain patterns are developing.

> **The key element of credit analysis is the determination of changes in the ability of a government to meet short-term and long-term debt service obligations.**

Of the 45 survey respondents (cities, counties, and states), all but one of the governments plan to implement Statement 34. Early implementation is planned by 17 percent of the respondents. Under Statement 34, the financial statement figures reported in the net-asset category will be affected by assets and the related liabilities that are reported on two different financial statements. This practice is followed by 17 percent of the respondents. A further effect on the net-asset category will be governmental assets that historically have not been tracked to the corresponding long-term financing. Only 43 percent of the respondents report tracking assets to the related long-term obligation. A significant 23 percent of managers expect that elected officials will formally adopt a standard for the degree to which infrastructure will be maintained.

Many county and city governments currently have an asset-reporting database that includes infrastructure (47 percent of the respondents). Several of these governments plan early implementation of statement requirements. Nearly all those surveyed feel that when database modifications are necessary the costs will be minimal. The survey indicates that total costs to implement Statement 34 range from $35,000 to $500,000 for cities, $35,000 to $2 million for counties, and $2 million to $4 million for states. These costs are to update financial-reporting systems and add or train staffs. A significant proportion of the respondents—33 percent—have not yet quantified the cost of implementation. Nearly all the respondents anticipate timely financial-statement preparation by the dates required by the statement, and only one expects issuance to be delayed.

Long-Term Operations

The Statement of Net Assets and the Statement of Activities that will exist under GASB 34 will provide a macro-level view of financial and economic resources and obligations. The key element of credit analysis is the determination of changes in the ability of a government to meet short-term and long-term debt service obligations. The assessment of this ability could be enhanced by using information contained in these two statements if the categories in the net-asset sections contain sound estimates. Establishing sound estimates for the valuation of infrastructure is the challenge. For the valuations to be meaningful to credit analysis, they must be comparable across entities and validated by objective and accepted standards. The issue and challenge for governments is what value to assign infrastructure that has been acquired or constructed since 1980 that could withstand external evaluation.

The costs of implementing GASB 34 will be due to changes to the reporting format and actual financial statement preparation, rather than to new costs for databases to record infrastructure. Changed or new requirements introduce additional information that can be used in credit analysis and that illuminates further the related activities for a particular governmental unit. The calculation of net assets now includes fixed assets, infrastructure, and long-term debt. Before adoption of GASB 34, the cumulative effect of the investment in fixed assets was hidden away in the fixed-asset group of accounts and the total net value represented by past decisions was isolated.

Estimates of Fixed Assets and Infrastructure

The estimates for fixed assets and infrastructure must be sound in order to make meaningful assessments regarding an entity's net assets that will be generated from future operations. Of the respondents surveyed, 43 percent report having a system that ties assets and the related liability. This information is vital to reporting the net investment in capital. It is possible that implementation of fixed assets and infrastructure estimates and the accompanying liability could be mismatched.

An example of a mismatch of assets and long-term liabilities is when debt is issued by one government for another governmental entity, such as a hospital or public university, and the entity is not reported on the government's financial statements as a component unit or an enterprise. This obligation would probably be recorded as an undesignated net asset on the Statement of Net Assets and could cause this category to be understated or even result in a deficit position. This obligation on the government's financial statements could uncover a problem on the part of the issuing entity for debt that cannot be repaid. In such a case, an explanation by management would be needed to eliminate potential credit concerns.

Reporting standards that are not met can cause a qualified audit opinion to arise regarding fixed-asset and infrastructure reporting, as has occurred in past years. Since fixed assets and infrastructure have become integral parts of calculating net assets, a qualified opinion could have a measurable impact on assessing an entity's credit quality. While the net-asset figure under Statement 34 is defined as a net economic (rather than financial) resource, most investors in bonds, legislators, and other users will attempt to use this information in the same way general fund balance and enterprise retained earnings are currently used.

Recording Depreciation on Infrastructure

Fixed assets do not have to be depreciated, but most respondents expect to depreciate infrastructure rather than use the modified approach to value infrastructure assets. Depreciation involves expensing during the life of an asset an amount each year that records the use of the asset. Under the modified approach, infrastructure assets are valued and each year a routine investment is made to keep the infrastructure near its original value. This method requires a condition assessment of the infrastructure's valuation, presumably by a third party, every three years. A final requirement for using the modified approach is the maintenance of a database that records initial values, new investment, and capital maintenance.

> **Establishing sound estimates for the valuation of infrastructure is the challenge.**

The majority of the respondents currently record both fixed assets and infrastructure. To many, the modified approach appears complex and costly to implement. Although government managers generally do not intend to use the modified approach initially, many intend to have elected officials adopt policies regarding the condition of infrastructure. GASB requires only that such a policy exist for the modified approach. Standard & Poor's, however, recognizes the value of adopting such policies for debt and reserve balances that guide budgeting and planning and minimize political or subjective influences.

It is quite possible, particularly in the early years of implementation, that the choice of whether to depreciate assets or use the modified approach will lead to widely differing results in valuation. This will require more thorough analysis to ensure comparability.

NEW INFORMATION ABOUT CURRENT OPERATIONS

Funds that report debt service, or for which revenue is pledged for debt service, will always be of importance to credit analysis, regardless of which funds are determined to be major (under the 5 percent and 10 percent rules) under Statement 34. The elimination of interfund transactions from the longer-term Statement of Activities and Statement of Net Assets provides a clearer picture of resources and obligations generated through arm's-length transactions. It is important to measure trends in grants and state aid and whether these are recurring. The proportion of government operations financed by payments received from intergovernmental sources is another important measure. Direct and indirect costs of debt issuance and the types of programs funded will be disclosed more fully than in the past.

Credit analysis benefits from incorporating new information that reflects how programs are financed and the relative proportions represented by direct-user charges or property taxes. Another benefit of including direct and indirect debt service cost by program is that it shows the true cost of delivering a particular service and the recurring budgetary impact of a particular decision. This is an example of how the financial information needs of credit analysts, elected government officials, taxpayers, and managers overlap.

New Benchmarks

Standard & Poor's expects that local governments will begin providing some additional information and benchmarks as a result of Statement 34 implementation. These include:

- Debt as a percentage of infrastructure and trends over time
- Debt service expenditure as a percentage of all operating and business expenditures or revenue
- More attention focused on debt service as a percentage of a component unit's operations
- Direct program support through user charges
- Net assets (invested in capital and undesignated) as a percentage of total expenditures
- Property tax revenue as a percentage of program expenditures
- Greater disclosure of discretionary versus nondiscretionary revenue as a percentage of program revenue
- Trend analysis of operations of major programs.

SUMMARY

The implementation of GASB 34 will provide additional information about governmental entities. The expanded information could benefit users such as citizens; decision makers; elected officials; credit analysts; and, indirectly, the entire credit market where capital is raised to support government services and operations. Nearly all the governments Standard & Poor's surveyed agree that this is a benefit of Statement 34. The changes certainly affect credit trends and comparisons in both the short and long term because of staggered implementation dates for financial statements and the inclusion of infrastructure valuation.

The usefulness of financial statements will be determined by the quality of the information, the comparability of valuation, and the way transactions have been tracked in the past. It is positive that many governments have systems to track fixed assets, and necessary modifications to add infrastructure will be minimal. However, there will be an impact on the usefulness of the net-asset figures—both those that are invested in capital and those that are undesignated—if assets are not matched to liabilities. It remains to be determined how a qualified opinion will be viewed when credit quality is assessed, particularly as it relates to fixed-asset and infrastructure reporting.

Governments that consistently have had strong management teams sensitive to the needs of credit analysis combined with past investment in databases to track assets and obligations tend to be better positioned to implement Statement 34. Many of the higher-rated credits—those rated in the AA category or above—tend also to be further along in implementation. Higher-rated credits tend to have experienced management teams as well as larger staffs to ensure that policies and systems are in place to measure accountability and stewardship. These entities are accustomed to routinely reporting results to a broad base of users. The implementation of Statement 34 benefits from past good-management practices.

Implementation in Alexandria, Virginia

This section was written by Laura Triggs, certified public accountant and deputy director of finance/comptroller for the city of Alexandria, Virginia. She has also served with the District of Columbia as associate chief financial officer, with the U.S. General Accounting Office, and with KPMG where her auditing work included government institutions.

Alexandria, Virginia, with a population of almost 122,000, is located on the west bank of the Potomac River, six miles south of Washington, D.C., and nine miles north of Mount Vernon. In 1749, the Fairfax County surveyor—traditional accounts say he was assisted by 17-year-old George Washington—set aside 60 acres for the city, making it almost fifty years older than Washington, D.C., and one of the most historic communities in the United States.

This historic city has already introduced the new financial reporting standard, known as GASB Statement No. 34, from the Governmental Accounting Standards Board (GASB), which makes sweeping changes to the way municipalities report their finances. In Alexandria, we are taking this sweeping change as we took many other sweeping historic changes that have influenced this city. In 1754, George Washington trained militia troops in front of today's city hall, and the town served as a supply and hospital center during the Revolutionary War.

The city's finance department has trained its financial reporting troops and made sure the city had adequate supplies to start implementing the GASB 34 changes in the fiscal year (FY) 1999 comprehensive annual financial report (CAFR).

To do this, Alexandria first had to figure out what the reporting model meant, what was necessary to do, and with whom we needed to confer. After we decided to implement early, we discovered that the mountains of new information we expected to hike over were well-traveled trails of familiar data.

WHAT THE GASB 34 REPORTING MODEL MEANS

For local government managers and administrators, the reporting model will provide additional tools for comparing your community with other jurisdictions and your own progress goals. One purpose of any financial report is to make it comparable with those of your neighbors. In the United States, we measure everything from the number of streetlights per square mile to the number of lawyers per capita. The reporting model attempts to make some financial information more comparable than it has been in the past.

We discovered that the mountains of new information we expected to hike over were well-traveled trails of familiar data.

The reporting model also provides information about your programs that enables a better comparison of programs over time. Many jurisdictions are using performance measures as one means of determining how they are doing. The reporting model can provide additional information for this analysis. You can combine the additional information the model provides on the cost of services for government jurisdictions with other information you already have on how your departments or agencies are performing. The reporting model doesn't tell you the cost of a pothole, but you will have additional data from which to make resource allocation decisions.

Citizens are demanding more information about the programs they are funding. In making some quantification for program costs, the reporting model makes headway toward answering citizen questions. Alexandria's reporting model analysis shows that we spend a great deal of our own resources on education and public safety. Because these are some of the city's priorities, we are glad the reporting model confirms this.

The reporting model is both an accountant's dream and an accountant's nightmare. Implementation of an accounting standard as large and as complicated as this one is like some of the math word problems we had in school. Most accountants will not admit this, but they enjoyed solving those math word problems. With the reporting model, accountants must solve a complex word problem with numerous alternatives. In addition, much of the reporting model needs to be set up on a computer spreadsheet. Give accountants problems that can be solved using spreadsheets, and they are happy.

The nightmare part of the reporting model can come with verifying the numbers that support the information in the spreadsheet. All the information going into the reporting model equation comes from financial records. These records may be easy to find, may be packed away in boxes, or may no longer exist. This financial information has to be assessed and monitored before the information can be placed in the spreadsheets. For an accountant, finding the right number can quickly turn into a never ending task. In the city of Alexandria, we found that we have much better information on our infrastructure than we thought.

In addition to affecting the accountants and the city decision makers, the reporting model can affect the citizens. Although the average citizen does not sit down and read a local jurisdiction's financial report (which does not mean that they do not know the jurisdiction's finances), the financial report has always been a reference tool for interested citizens, elected officials, and staff. The new reporting model will not eliminate that. Instead, it provides a new set of tools. It is always good to have more than one way to view something. In Alexandria, we have citizen committees that examine everything from budget priorities to cash management techniques. We know that the reporting model will allow them to ask even more and better questions. We welcome the opportunity.

Misconceptions and truths

It is arguable that the new reporting model has generated more publicity than any other governmental accounting pronouncement. Governmental accounting standards usually do not make the front page of national newspapers, but this one did and so did misconceptions about it. Here are two of those potential misconceptions:

Misconception: Implementing the reporting model will take more resources than Y2K.
Reality: Implementation will take a concerted effort, but the effort is based largely on what you already know—familiar territory.

Misconception: It will change dramatically the way citizens view their city.
Reality: The model will provide additional tools to allow citizens to ask more informed questions about the financial condition of their city.

OUR REPORTING AUDIENCE

The reporting model represents a tool with which we can provide more financial information about our city. As accountants, we often provide new financial information but do not spend much time talking about it to anyone but ourselves. As with most new ideas, the changes required by the new reporting model may take some people longer than others to understand. In Alexandria, however, we have found that the more we talk to people about how our implementation plans are progressing, the better they feel about their own ability to understand what we are doing. Key people have been affected in a variety of ways:

City Council and City Manager

At numerous times over the course of the past decade, we briefed the city council and the city manager on GASB's consideration of the Measurement Focus Basis of Accounting project. As GASB Statement No. 34 unfolded as the end product of that effort, we briefed the city manager and obtained the manager's approval to implement GASB No. 34 earlier than what was mandated. We started with the FY 1999 CAFR; we put the new reporting model statements in the statistical section of the 1999 CAFR (which meant the statements were not audited by our external auditors and the statements were in the back of the CAFR). This was in effect a test drive of the new statements to get feedback from the various constituent groups before the reporting model implementation date. Because the new statements were put in the CAFR—in the public spotlight—and not filed away, it also made the reporting-model work real and not academic.

Auditors

Every city with an independent audit has a team of experts on the reporting model. Alexandria is going to implement the reporting model once; auditors will implement it over and over. Talk to the auditors. See what pitfalls they have seen. Ask what makes them nervous. In Alexandria, we began discussing our implementation with our external auditors in FY 1999, before the final GASB No. 34 release. We are working with them to have them review as many documents as possible as early as possible. For example, we made an initial assessment of our infrastructure by reviewing our capital budget and bond documents. We determined that our capitalization threshold for financial reporting might be lower than we prefer. Before changing our policies, we discussed the potential implications. Our auditors encouraged us to review all the aspects of our capital policy to ensure that it met the requirements of the reporting model.

Rating Agencies

Another group that sees many financial statements but may look at them a little differently from your auditors are the rating agencies. If you are planning to borrow money any time in the next century, the rating agency will look at your statements under the new reporting model. When Alexandria last visited the rating agencies, we discussed our reporting model implementation plans with them, showed them how the city's FY 1999 audited financial information would look in the new reporting format, and received positive feedback. We believe this conversation will help everyone's understanding of what this implementation means for our financial position, as well as give the rating agencies additional tools to assess the financial condition of our local-government neighbors.

Citizens

Most citizens do not want to know how many spreadsheets you used to implement the reporting model. But they might be interested in what you will be reporting. If you are going to start reporting infrastructure information, let your citizens know what that means for your city. Alexandria has a key citizen committee that carefully reviews the city's budget and other financial data. We have kept the committee apprised of all changes we contemplated with regard to our financial reporting.

Information Technology Staff

Providing new information in a perfect world would mean a few points and clicks of your computer mouse and the information would be re-sorted and presented exactly the way it should be. Unfortunately, the computer systems governments use to capture financial data are large, complicated, and sometimes antiquated. To judge how well you will be able to get the same information in a new way, think about the last time you needed a new type of financial report. If it took more than a few mouse clicks to get that information, you will need to spend time talking with your information technology staff about the reporting model.

In Alexandria, the information technology staff responsible for the financial management system has always been responsive to change. We have obtained several reports on our assets and revenues that we used to assess how much more work we would need to do in order to comply with the new reporting mode. In most cases we had enough information, but there were a few cases, primarily involving assets, in which having these reports helped us determine other steps we would need to take.

Accountants

We recommend going to training sessions being held on the reporting model. Even if you are not an accountant, these sessions can provide information on what the reporting model might mean to your jurisdiction. You will hear what concerns people have, and you can make a preliminary assessment of the impact of those concerns on your jurisdiction. As with any new idea, most people are willing to give you advice on how to be successful in your implementation. In Alexandria, we went to several different training courses. Each staff member who attended had questions or concerns that we had not previously addressed. Again, we believe in having ample information to make a decision even if we do not like the information we receive. On the basis of new information, we had several discussions with our accountants about roads maintained by the state and about our city art collections. Information we learned at these training sessions helped us to come up with a policy that we believe will comply with the concerns of our auditors.

WHAT WE DID

The people leading the charge to early implementation in Alexandria were most definitely accountants. Accountants love to figure out how new rules affect the way we report information. More important than having gleeful accountants, though, was determining what the city might gain from early implementation. We believe early implementation gives us a stronger position to advocate our interpretations of the standard. Waiting until everyone else is finished implementing might give us fewer options for presenting our information.

Implementing early also allows us to have feedback from anyone who wants to pick up our financial report. At the time we complete implementation, not many other jurisdictions will have implemented the model, but there will be plenty that are knowledgeable about the reporting model. We want to hear what others think. We believe it is better to go out there first, even if we risk having some interpretations changed over time. We believe implementing our way gives us more options for advocating our position.

> **We believe early implementation gives us a stronger position from which to advocate our interpretations of the standard.**

For example, we are currently planning to record actual expenditures for our infrastructure and record depreciation. We made this decision on the basis of the amount of information we have available on our infrastructure. We have records going back more than 20 years that allow us to have a pretty clear picture of where we spent our infrastructure dollars. We are interested in seeing if others think our approach is realistic for their jurisdictions, especially jurisdictions in which financial records do not go back to 1980.

Implementing early allowed us to use a phased-in approach to implementation. For our fiscal year 1999 financial report, we included three schedules that will be required under the reporting model. Preparing this information gave us a sense of what was coming and what we had left to do. Going through that exercise helped shape our discussion on where to focus our energy for full implementation.

WHAT WE FOUND

We found that implementation is very attainable. We found that it is like saving for retirement: the longer you wait to start saving, the more you must save later. With the reporting model, the longer you wait to figure out what to do, the more you must do later in a shorter period of time. Numerous tasks associated with the reporting model do not take much time. Other tasks could stop the project. Many people will help you come up with a time line and resource allocation plan to get you to implementation. Make that plan. Do not let any specific step get you off track.

The most reassuring discovery of our implementation plan was that much of the new reports are a new presentation for familiar information. Our finance staff compares the new model reports to a jigsaw puzzle. We already have all the puzzle pieces; we just have to spend some time putting them in the right places. We recommend figuring out what information you have and how to use it in the reporting model. Under the current reporting system, you must report specific information about your funds. Guess what? The new re-

GASB 34 in perspective

As with any new product, some people will want the reporting model to be all things to all people. Reality tells us this is rarely the case, but the model will give you some crucial and useful information about your assets, tax collections, loans, and the cost of services in your jurisdiction. The model is the first attempt to report substantially on all the assets of a government. Of course it will not report everything, but it is a major step.

Press reports on the reporting model indicate it is possible to learn everything from the value of the Brooklyn Bridge to the value of museum's holdings. While this is not false advertising, a few cautions are in order.

What is the Brooklyn Bridge worth?
As far as the value of the Brooklyn Bridge goes, you won't get that from the new model. The new model reports assets at historical cost whether you estimate them or record the original bills of sale. None of these methods uses fair market value. If you are hoping to compare the Brooklyn Bridge with the San Francisco Bay Bridge, the reporting model will not be the way to accomplish this.

Is valuing art an art form?
The new model also allows jurisdictions to record historical treasures in their financial statements. The methods for valuing these treasures can vary among jurisdictions. You may not be able to determine which priceless collection is worth the most.

Is your city worth more than the one in the next county?
Several years must pass before the reporting model will be fully implemented. For example, only infrastructure placed in service in the last 25 years is required for the reporting model. Also, the infrastructure portion of the model does not have to be implemented for seven more years in some cases. All of these limitations won't keep people from making comparisons between cities. The standard certainly provides a great deal of information that will make these comparisons easy and entertaining. As with every other numerical comparison, the nonquantitative aspects of your city may not come through on this financial odyssey.

What do you own and what do other jurisdictions own?
Cities, counties, states, and the federal government have long shared the cost of many large projects; and in the state of Virginia, the state often treats cities and counties differently. For example, Virginia builds roads for cities and then turns them over to the city governments, but most counties pay for their own roads and take on the debt to do so. Therefore, cities that use this new reporting model may appear to have obligations that differ from those of other local jurisdictions. The guidance from the reporting model is good, but it may take a few years until we can clarify all the different ownership issues in specific areas (such as road ownership).

porting model also requires information about your funds. You just have to analyze the data a little differently.

We also found that we already have much of the new information we need to record infrastructure. Most jurisdictions have not recorded financial information about infrastructure anywhere in their annual financial reports, but that information most likely has been reported somewhere. Most jurisdictions have budget books, bond documents, and city council meeting minutes and notes. In addition, we learned a great deal about Alexandria's infrastructure by talking to various city officials. Incomplete accounting records can often be augmented by information maintained by other departments. Our discussion with city officials turned up project names and time frames that allowed us to narrow down vague project descriptions to something that could be more easily verified by our external auditors. We do have an advantage in Alexandria of having installed much of our infrastructure far more than 25 years ago: not having to locate cost information on eighteenth- and nineteenth-century granite curbs and cobblestone streets made our task slightly less burdensome.

When we recorded infrastructure, we did find that we had some clean-up work to do in our financial accounting records. By using a phased-in approach, we knew what information needed to be cleaned up before we began reporting with the new model. For example, we have reviewed and assessed our capitalization policies to ensure that all our capital maintenance policies reflect what we need to be recording under the new model.

The staff in the city of Alexandria is certainly not finished with the reporting model experience. We are glad we have started it. As the city struggles with all the issues that bring us into the new millennium, we hope the financial reporting will make dealing with some of those issues easier.

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