WHAT IS GASB 34?

In June 1999, the Governmental Accounting Standards Board (GASB)—which sets "generally accepted accounting principles" (financial reporting rules) for all state and local governments—adopted the most sweeping changes in financial reporting in its history.

Known as Statement No. 34: Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, this represents a fundamental revision of the current financial reporting model, which has been in place since 1979. While there are a number of significant changes (the statement is 403 pages long), the major ones are:

Two Kinds of Financial Statements. Two distinct forms of information will be provided in the basic financial statements:

• Government-wide statements. These are consolidated financial statements for all of a city's operations on a full accrual basis of accounting. They will not be presented on a fund basis; instead, fiscal operations will be organized into two major activities: governmental and business-type. They will have a "net asset" focus, and exclude interfund transactions (such as internal service funds) and fiduciary funds. Expenses (which may include allocated "indirect costs") will be shown both gross and net of related revenues such as fees and grants.

• Fund statements. In meeting stewardship and accountability concerns, financial statements will also be presented on a fund basis—but not using the same basis of accounting as the government-wide statements for government funds.

Because there will be differences in the basis of accounting and scope of transactions, there will be significant differences between these two financial statements—but they will not be obvious. For this

reason, a detailed reconciliation between them will be required as part of the audited basic financial
statements.

Focus on Major Funds. In the “fund section” of the report, statements will focus on major (large)
individual funds rather than on consolidated fund types.

Required Supplementary Information (RSI). There are two new elements to RSI:

• Management’s discussion and analysis (MD&A). Many cities already prepare a comprehensive
transmittal memorandum as part of their annual financial report. For some of them, this new
“MD&A” requirement may not pose a significant additional work element. However, due to the
addition of government-wide statements (and required topics), the scope (and related work effort)
will certainly increase. Additionally, since this will now be a required part of the basic financial
statements, audit costs will probably increase.

• Budget reporting. Comparisons of “budget-to-actual” results for the governmental funds will no
longer be required as part of the basic financial statements—but this will be RSI. And there will
be an added requirement: both the original and final budget must be presented.

Basic Financial Statements. The following summarizes the presentation of basic financial statements
under the new model:

FINANCIAL STATEMENTS
Government-Wide (Full Accrual)
Governmental Activities
Business-Type Activities
(No Internal Service or Fiduciary Funds)
Fund
Governmental (Modified Accrual)
Proprietary (Full Accrual)
Fiduciary (Full Accrual)
Notes to the Financial Statements
REQUIRED SUPPLEMENTAL INFORMATION
(Other than MD&A)
MANAGEMENT'S DISCUSSION AND ANALYSIS
No Account Groups. General fixed assets and long-term debt will no longer be shown as account groups.
They will now be included in the government-wide financial statements as assets and liabilities.

Depreciation for Governmental Activities. Under the current reporting model, depreciation is not
recorded for "governmental" capital assets, such as those purchased through the General Fund. The
traditional rationale for this is an appropriate focus on "available spendable resources"—which is based
on the simple fact that programs and projects cannot be funded through the budget process based on the
current net value of fixed assets. However, in order to allocate the cost of these assets over their useful
lives, the new model will require depreciation of general fixed assets. Correspondingly, the "government-

wide" financial statements will not show capital expenditures (nor will they show the principal
component of debt service payments as expenditures)—but the fund-based statements will.

Recording Infrastructure as Capital Assets—and Expensing Them Through Depreciation. Current
accounting principles do not require reporting the cost of infrastructure such as roads, bridges, storm
drains, street lights, and traffic signals as capital assets—not because they aren't major community
investments, but because they are immovable, and only of value to the government (except in the oft-told
tale, there really isn't much of a market for the Brooklyn Bridge).

The new reporting model requires that infrastructure be reported as its "historical" (not current) value, and
then depreciated like other assets as discussed above. (There are several complicated options for how to
do this, including not depreciating infrastructure assets at all if there is an adopted maintenance plan, and
assets are being maintained in accordance with that plan.) Almost all municipal finance officers across the
country vigorously opposed this change as being very expensive with limited practical value.

Basic Model
(Prospective
Retroactive
Infrastructure
Infrastructure
Total Revenues
Reporting)
Reporting
Effective for Fiscal Year
$100 million or more
2001-02
2005-06
$10 to $100 million
2002-03
2006-07

Under
$10
million 2003-04
not
required

Cities that have long-term debt for infrastructure assets will probably want to retroactively report
infrastructure in conjunction with the new model to better match long-term liabilities and assets.

SO WHAT'S THE BIG DEAL?

Under GASB 34, local and state government basic financial statements will become longer and more
complex—and thus more difficult to prepare and audit. This will be especially true when converting to
the new model.

This increased difficulty and complexity directly translate into increased costs—both one-time during
implementation and ongoing thereafter—for staff resources as well as audit fees and consultant services.

Will the effort and cost be worth it? Goals for the new model include:

- Improving financial reporting
- Enhancing awareness of fiscal issues facing states and local governments
- Recognizing the importance of adequately maintaining infrastructure
- Size and complexity of the city's operations

• Finance staff resources
• Age of its infrastructure
• Availability of reliable information about current infrastructure systems

For communities with relatively new infrastructure, this may be a less difficult undertaking than in older cities; and implementation and ongoing support may be easier for cities that have already extensively documented their infrastructure through geographic information systems (GIS) or established maintenance systems like pavement management plans.

In evaluating costs, cities will need to consider both the one-time and ongoing costs to: prepare the additional financial information, develop and maintain the infrastructure data, and audit the results. In most cases, at least initially, outside accounting and engineering resources will be needed to implement the new model.

Two Case Studies. Two cities in California recently prepared “sample” financial statements under the new model: Tracy (pop. 54,200) and Corona (pop. 123,000). For Tracy, Maze & Associates did the accounting work, and Berryman & Henigar the infrastructure work. For Corona, Caporicci Cropper and Larsen did the accounting, and Charles Abbott and Associates the infrastructure. As “pilot” case studies, all four firms donated their time in preparing the sample statements. However, the following are estimates of the value of this donated work, excluding the significant staff work that was also required.

• Tracy. Estimated costs are $25,000 for changed financial statement presentation, note preparation, and MD&A review; and $25,000 to develop the infrastructure data.
• Corona. Estimated costs are $30,000 for changed financial statement presentation, note preparation, and MD&A review; and $11,000 to develop the infrastructure data. (As noted below, this work built on a recently completed, comprehensive fixed asset inventory that cost $55,000 to complete.)

These implementation costs, ranging from $40,000 to $50,000, should be considered “order of
magnitude” estimates—and “best-case” ones for comparably sized cities for the following reasons:

• Tracy and Corona start from a solid financial statement base: They already prepare their annual
financials report in accordance with the high standards of the GFOA and CSMFO programs for
excellence in financial reporting.
• Their infrastructure assets are relatively new and GIS applications are in place. Tracy has a
comprehensive pavement management program, and Corona had just completed a $55,000
appraisal of its fixed assets, providing a solid starting point.
WHY IMPLEMENT IT?

If GASB 34 is going to be so difficult to implement, and the benefits so unclear, why do it?

The new model is supported by a number of users and professional associations. The National
Association of State Auditors, Comptrollers and Treasurers has endorsed the new model, and so have the
credit rating agencies (who are the primary “users” of these reports). There are many public works
officials who believe the new reporting model will result in a better understanding of infrastructure needs.
And a number of well-respected municipal finance professionals think the new reporting model tells a
city’s fiscal story better, and is a significant improvement over the current model.
It’s “GAAP.” This is probably the most compelling reason for implementing the new model. GASB is the
acknowledged authoritative body in setting generally accepted accounting principles (GAAP) for local
and state agencies. Maintaining citizen confidence in our stewardship of the assets entrusted to us requires
credibility and integrity in our accounting and financial reporting systems. And preparing audited
financial statements in accordance with industry standards provides an essential foundation for gaining
and sustaining this trust.

For this reason, despite its reservations about some of the changes in the new model, the California Society of Municipal Finance Officers (CSMFO), which represents more than 1,000 local government finance professionals throughout the state, has strongly encouraged its members to implement GASB 34.

## SUMMARY

GASB 34 represents a major change in financial reporting for local and state governments. While there are concerns about the value of some of these changes (most notably infrastructure reporting), there is widespread agreement that cities should implement these changes in order to prepare audited financial statements in accordance with generally accepted accounting principles.

For many cities, implementing the new model should not be an overwhelming task—but for all cities, it will mean careful planning, staff training, and allocating the resources necessary to successfully make this change.