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Governmental Accounting Standards Board Statement 34: Perceptions of Texas Finance Officers

Keiji Shirota
Texas State University-San Marcos, Political Science Department, Public Administration, shirota77@hotmail.com

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Governmental Accounting Standards Board *Statement 34*: Perceptions of Texas Finance Officers

By Keiji Shirota

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Abstract

The recent corporate scandals have made us aware that even Fortune 500 companies with seemingly stellar performances may not be financially as well off as their financial statements suggest. The corporations involved in the recent flow of scandals have previously been considered as top-notch companies. Despite their good reputation, some of them have declared bankruptcy, and one lost its auditing license in Texas. These events pose a question as to how reliable financial statements are.

Financial statements are not only used in the private sector, but also used in the public sector to allow decision makers to communicate with their stakeholders. Stakeholders in the corporate setting may include stockholders, bondholders, and employees. In the public setting, stakeholders may include citizens, bondholders, and decision makers themselves. Even though stakeholders demand accurate information regarding the well-being of their respective organizations, the recent corporate scandals infer that information may not be accurate or adequate.

There are two organizations that are tasked to establish and improve financial reporting standards in US: one for the private sector and the other for the public sector. Their efforts to improve the reporting standard, known as Generally Accepted Accounting Principle (GAAP), have met considerable resistance in the past.[1] One of which is the focus of this research.

[1] GAAP: Generally Accepted Accounting Principle established by the GASB and the Financial Accounting Standards Board.

Statement 34 issued by the Governmental Accounting Standards Board (GASB) has caused uproar among public finance officials all over the nation.[2] *Statement 34* introduced one important concept to the public sector, which is *operational accountability*. But, in order to do so, the GASB increased the reporting requirement of state and local governments. This apparently led to a series of debate over the efficacy of *Statement 34*.

Thus, the purpose of this research project is to describe the attitudes and perceptions of public finance officials in Texas about *Statement 34*. The researcher explores the attitudes and perceptions by surveying one-hundred public finance officials in Texas about *Statement 34* by the Governmental Accounting Standards Board.

The results indicated that public finance officials in Texas agreed that *Statement 34* compliant financial statements provided adequate information for fiscal and *operational accountability*. However, they are not as comprehensible as originally intended. In addition, public finance officials in Texas agreed that the costs of implementation outweigh its benefits.

[2] GASB is a private sector agency founded by the Financial Accounting Foundation to establish accounting and reporting standards in the public sector. The standards set by the GASB become the Generally Accepted Accounting Principle in the public sector, otherwise known as GAAP (Wilson and Kattelus 4).

Chapter One – Introduction

Introduction

With rising costs of governmental activities and a highly volatile economy, citizens are becoming more tuned to the amount of taxes they must to pay to governmental entities. Citizens need more services, but are not willing to pay more taxes. In order to justify the cost of public service to citizens, many state and local governments have adopted the reporting standards established by the Governmental Accounting Standards Board (GASB).[3]

State and Local governments publish their financial reports and distribute them to the public annually. Such reports allow citizens and other stakeholders to hold government officials accountable. But, how reliable are those reports? In order to resolve the reliability problem, the Governmental Accounting Standards Board (GASB) was created. The GASB establishes financial reporting standards for governmental non-profit entities, and state and local governments. GASB has issued forty-one statements to establish and improve financial reporting standards in the public sector. Public finance officials have generally accepted standards issued by the GASB in the past. However, one standard issued by the GASB has caused a series of criticisms and oppositions from the practitioners: the standard is called *Statement 34*. *Statement 34* significantly increased reporting requirements by introducing many new components and an important concept previously not required. One big concept that *Statement 34* introduced was *operational accountability*. Public finance officials have always dealt with *fiscal*

[3] GASB is a private sector agency founded by the Financial Accounting Foundation to establish accounting and reporting standards in the public sector. The standards set by the GASB become the Generally Accepted Accounting Principle in the public sector, otherwise known as GAAP (Wilson and Kattelus 4).

accountability in the past, but *operational accountability* was foreign to them. *Fiscal accountability*, operationalized by a combination of the *modified accrual method* and fund accounting was the major form of financial reporting in the public sector until the introduction *of Statement 34*.

Purpose Statement

The purpose of this study is to describe public finance officials' assessment of the characteristics of the new standard, *Statement 34* on local governments in Texas. One of the missions of *Statement 34* is to provide adequate information to the users of financial statements, not just for *fiscal accountability* purposes, but also for *operational accountability* purposes. The GASB intended to require state and local governments to publish financial statements that are easily readable and comprehensible. The GASB wanted to make financial statements more accurate in terms of presentation by introducing techniques used in the private sector. *Statement 34* attempts to accomplish those purposes mentioned above. In spite of good purposes, implementation of such an enormous project is not easy or low in cost. In fact, many respondents of the survey conducted for this research mentioned their concerns over the cost of implementation. Thus, the following categories are used to conceptualize public finance officers' assessment of the characteristics of *Statement 34*: Adequacy and Accountability of Financial Statements, Usefulness of Information, Accurate Presentation and Cost of Implementation.

This research is conventional in that it provides a review of literature on how government officials have coped with such change, how government officials plan to

implement changes in their financial accountability system, and how others could help state and local governments achieve that goal. However, the research is unique because it provides feedback from the public finance field by surveying financial officials in local governments and the users of financial statements.

Governmental accounting standards define the way financial information should be presented to the citizenry. Citizens can use such information provided by local and state governments to hold governmental entities accountable for their expenditures. Governmental entities raise tax dollars from citizens who do not expect proportionate monetary gains from government services. With the exception of enterprise funds, governmental entities do not provide goods or services for profit (Wilson 2002, p. 3). Because of the unique purposes that governmental entities play in our society, justification of governmental spending on programs is important. Governmental accounting standards help citizens and other stakeholders to hold government officials accountable for how they spend tax-dollars. This is an important area of study that has not been well researched in the past. The research is an effort to accumulate knowledge on the impact of changes in governmental accounting procedures.

Chapter Two – Background in Governmental Accounting

Introduction

The purpose of this chapter is to review the literature on the impact of the Governmental Accounting Standards Board (GASB) *Statement 34* for local governments in Texas.[4] This literature review creates a foundation for further research on public finance officials' assessment of characteristics of *Statement 34* in Texas.

GASB's Mission

The Governmental Accounting Standards Board (GASB) is a private sector agency created by the Financial Accounting Foundation to establish accounting and reporting standards for the public sector. The GASB's mission statement follows:

> The mission of the GASB is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports and guide and educate the public, including issuers, auditors, and users of those financial reports (GASB 2002-2003, p. 1).

The GASB's mission states that the standards are issued not only for the public, but also for issuers as well. For the purpose of this research, the external users are defined as general public and the municipal bond market, and the internal users will be decision-makers. The GASB attempts to make Generally Accepted Accounting Principle (GAAP) compliant reports not only for external users, but also for internal users.[5] However, Ken Schermann (2001, p. 36) takes a position contrary to the GASB. The focus of the GASB is external users. Wilson and Kattelus (2002, p. 7) also make a

[4] GASB is a private sector agency founded by the Financial Accounting Foundation, to establish accounting and reporting standards in the public sector. The standards set by the GASB become the Generally Accepted Accounting Principle in the public sector, otherwise known as GAAP (Wilson and Kattelus 2002, p. 4).

[5] GAAP: Generally Accepted Accounting Principle established by the GASB and the Financial Accounting Standards Board.

position in support of Schermann that the GASB creates standard for external reporting, rather than for internal users. The GASB, the preparers of financial statements and users have differing expectations on the mission of the GASB itself.

The GASB as a private entity with no legal mandate has no formal power as a rule-making body for accounting and reporting in the public sector. As a consequence, State and local governments are free to follow any accounting and reporting standards. Even though the GASB possesses no legal power to enforce standards issued by the board, an overwhelming majority of state and local governments throughout the United States follow the standards issued by the GASB. "A typical state law may require municipalities, school districts, counties, and special districts in the state to prepare Generally Accepted Accounting Principles (GAAP) financial statements every year" (Schermann 2001, p. 37).[6] The GASB has an indirect power of law.

The members of the GASB believe that governments need to be held accountable for what they do, and financial reporting helps people hold governments accountable (GASB 1987, p. 4). State and local governments have to justify collection of taxes, and be held accountable for effective and efficient use of the taxes collected from the citizens. "Although skeptics argue that the public does not read government financial reports, a democratic government still has the obligation to report its financial affairs to the citizenry" (Chan, 2001, p. 80). The GASB provides the tools for state and local governments to be accountable to citizens through financial reporting. These tools are the issuance of reporting standards.

[6] GAAP: Generally Accepted Accounting Principle established by the GASB and the Financial Accounting Standards Board.

The GASB accomplishes the mission of providing useful information for users of financial statements by issuing standards. Previously, public finance officials have accepted the GASB established standards because the board employs due process (GASB 2002-2003, p. 2). Nonetheless, the GASB's effort to improve accountability in the government sector has met with considerable resistance from public finance officials in recent history (Hume 2000, Vol. 334 p. 2). The GASB has issued a new standard that stirred up controversy, which centered on a concept of the *accrual method* of accounting. The *accrual method* of accounting recognizes revenues and expenses when incurred, which had been considered incompatible with the public sector in the past. Thus, public agencies employed the *modified accrual method* in lieu of the *accrual method*. This is not to say that the *modified accrual method* is without problems.

Problems with the *modified accrual* method

State and local governments have used fund accounting, which separates appropriated funds by different categories due to legal mandates. In addition, fund accounting used the *modified accrual method* of accounting to report financial situations in the past.[7] Governmental entities in the twentieth century have used fund accounting, which was still in use when the GASB was established, despite many organizations had found that the *accrual method* was much easier to administer, and provides better control (Anthony and Newberry 2000, p. 36).

The *modified accrual method* is generally concerned with matching revenues and expenses, which places emphasis on inflows and outflows of money. The modified-

[7] The *modified accrual* method accounting: "recognizes as revenues only those inflows that are available to pay current-period obligations and recognizes as expenditures all obligations that will be paid from currently available financial resources" (Wilson and Kattelus 38).

accrual method of accounting is useful for short-term management based on cash flows, but is inadequate for long-term management of performance. According to Schermann (2001, p. 37), the conventional reporting method used by governments did not report all the information needed by users, such as a not showing a government as an economic entity with long-term perspective, but only as a short-term fiscal entity. "A common criticism was that there was some missing information: specifically, information about the government as an 'economic unit,' as an entity, rather than merely a 'collection of funds'" (Schermann 2001, p. 38). The *modified accrual method*'s narrow approach to accountability led to the GASB's effort to create comprehensive financial reporting.

In order to remedy this shortcoming with the *modified accrual method*, the GASB introduced *Statement 34*, which required governmental entities to use the *modified accrual method* for *fiscal accountability* and the *accrual method* of accounting for *operational accountability*. Wilson and Kattelus (2002, p. 8) define *fiscal accountability* as "whether the government has raised and spent financial resources in accordance with budget plans and in compliance with pertinent laws and regulations," and *operational accountability* as "whether the government has used its resources efficiently and effectively in meeting operating objectives." State and local governments have long used the *modified accrual method* to report *fiscal accountability* to stakeholders. Such reports, however, lacked information to properly assess governments' performances in terms of effectiveness and efficiency. The introduction of *Statement 34* revolutionized the accountability structure of state and local governments by requiring the use of *operational accountability* in addition to *fiscal accountability*.

The introduction of *operational accountability* in the public sector naturally leads to interperiod equity. Interperiod equity is defined as "a term indicating the extent to which current-period revenues are adequate to pay for current-period services" (Wilson and Kattelus, 2002, p. 3). The matching of current flows of revenues and expenses proportionally distributes benefits to generations that pay taxes. According to Wallace (2000, p. 195), *operational accountability* allows governments to show their economic resources, along with liabilities. Governmental entities have the power to tax and issue debt. When governmental activities are largely financed by debt that is not supported by current revenues it becomes a burden for the future generation. Interperiod equity is a significant part of accountability and fundamental to public administration (Kravchuk and Voorhees 2001, p. 2)

According to Johnson and Bean (1999, p. 1), the GASB had been facing the same dilemma since its inception: how to show the economic resources of government entities. The members of the GASB did not have a consensus as to what measurement focus to use for governmental financial reports (Patton and Bean 2001, p. 34). Rose (2000, p. 18) recalls an incident where GASB chairperson, Tom Allen had asked in a meeting if the members were for reporting the flow of economic resources or the flow of financial resources. Unfortunately, the members were not able to come to a consensus. Three voted for the flow of economic resources, and the other three voted for the flow of financial resources. As a result, "…the Board adopted Statement No. 34, Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments" (GASB 1999, p. 1), which includes both the *accrual method* and the *modified accrual method*.

> Under the current [old] reporting model, some funds (governmental and some fiduciary) use[d] the financial resources measurement focus and the *modified accrual* basis of accounting and other (proprietary and some fiduciary) use[d] the economic resources measurement focus and the accrual basis of accounting (Engstrom and Tidrick, 2001, p. 65).

Overview of GASB Statement No. 34

Introduction

The Governmental Accountings Standards Board's *Statement 34* is the most monumental change in governmental accounting (Hennen 2001, p. 1). It took ten years to develop because it was so controversial (Hume 2000, vol. 334, p.4).

> There are many controversial issues associated with GASB 34, which include adaptation of the *accrual method* of accounting to display long-term finances of organizations, display of all assets and liabilities, determination of value of capital assets, and also management discussion and analysis (Hume 2000, Vol. 334 p. 2).

Consequently, *statement 34* attracted more comments than any previous standards issued by the board (Rose, 2000, p. 18). According to Rose (2000, p. 18), the most comments came from the GASB's constituent organizations, such as the Association of Government Accountants, the Government Finance Officers Association, and the American Institute of Certified Public Accountants.

The adaptation of the *accrual method* of accounting to report economic resources is a daunting task because many governments are expected to create records of such assets (Wallace 2000, p. 182). State and local governments did not report such information in the past, which led governments to be held only accountable in terms of *fiscal accountability*, but not *operational accountability*. It had been optional to report infrastructure assets, such as roads, bridges, dams, etc, that had not been reported in proprietary funds (Patton and Bean 2001, p. 31). "Most governments chose not to report

these general infrastructure assets, and many did not maintain historical cost information for them" (Patton and Bean, 2001, p. 31).

The introduction of the new standard increased the reporting requirement to an unprecedented level by introducing the Management's Discussion & Analysis (MD&A), Required Supplementary Information (RSI), and government-wide statements using the *accrual method*, while keeping the traditional fund structure (Wilson and Kattelus 2002, p. 8).[8] [9] Such an increase in the reporting requirement caused practitioners to have differing opinions on the new standard (Cagle 2002, p. 2). Some argued that the *accrual method* has no place in the public sector, while some argued that the fund accounting needed to be replaced. For example, Anthony and Newberry (2000, p. 36) recommend that the 50 paragraphs on fund accounting be deleted from *Statement 34*. While others argued in contrary.

Table 2.1 Comparing Pre-Statement 34 and Post Statement 34

	Pre *Statement 34*	Post *Statement 34*
Accounting methods for governmental operations	*Modified accrual*	*Modified accrual* and *accrual method*
Capital assets	Optional in governmental funds	Reported in government-wide statements
Depreciation	Optional in governmental funds	Reported in government-wide statements

Implementation Schedule

Statement 34 (GASB 1999, p.4) states that, "the requirements of *Statement 34* are effective in three phases based on a government's total annual revenues." As the Table

[8] MD&A: "Narrative information, in addition to the basic financial statements, in which management provides a brief, objective, and easily readable analysis of the government's financial performance for the year and its financial position at year-end. An MD&A is required by GASBS 34 for state and local governments…." (Wilson and Kattelus 2002, p. 699).

[9] RSI: "Information that is required by generally accepted accounting principles to be included with the audited annual financial statements, usually directly following the notes to the general purpose external financial statements" (Wilson and Kattelus 2002, p. 705).

2.2 below presents, first, governmental entities with total annual revenues of more than 100 million dollars for the fiscal year ending 15 June 1999 would have fully implemented the new standard for the period beginning after 15 June 2001. Second, governments with revenue of more than 10 million dollars, but less than 100 million dollars would have to have the new standard implemented for the period beginning after 15 June 2002. Lastly, entities with revenue of less than 10 million dollars would have to have the new standard implemented for the period beginning after 15 June 2003 (GASB 1999, p. 4).

Table 2.2
Implementation Schedule for Statement 34

Required year of implementation	Fiscal year beginning after 15-June-2001	Fiscal year beginning after 15-June-2002	Fiscal year beginning after 15-June-2003
Total Revenue of a government entity	More than 100 million dollars	More than 10 million dollars, but less than 100 million dollars	Less than 10 million dollars

Robbins and Baldwin (2001, p. 1) state that *Statement 34* with a conjunction of the Statement No. 37 place local and state governments in a unique challenge of valuing their assets. "In the case of general infrastructure assets that must be retroactively capitalized, state and local governments have a grace period of four years after the adoption of the general provisions of GASB 34 to complete capitalization." The schedule for such assets follows in Table 2.3.

Table 2.3
Implementation Schedule for government entities with infrastructure

Required year of implementation	Fiscal year beginning after 15-June-2005	Fiscal year beginning after 15-June-2006
Total Revenue of a government entity	More than 100 million dollars	More than 10 million dollars, but less than 100 million dollars

Source: (Hendricks 2001, p. 1).

Chapter Three – Conceptual Framework

Introduction

The purpose of this chapter is to link the literature to four broad categories used to assess *Statement 34*: adequacy and accountability of financial statements, usefulness of information, accurate representation, and cost of implementation. The descriptive categories mentioned above is the assessment criteria for *Statement 34*, and these criteria form a conceptual framework.

Adequacy and Accountability of Financial Statements

As the previous chapter suggests, one of the major problems with the conventional reporting system was that it did not offer adequate information. Yet, the citizenry needs information on governmental activities to hold government officials accountable. Adequacy and accountability of financial statements are used as assessment criteria to evaluate *Statement 34*.

The first category, adequacy and accountability of financial statements, is divided into four subcategories: the Auditor's Report, the Management's Discussion and Analysis (MD&A), the Basic Financial Statements, and the Required Supplementary Information (RSI). Previously, a Comprehensive Annual Financial Report (CAFR) contained three sections: Introductory, Financial and Statistical (Engstrom and Tidrick 2001, p.64).[10] After the introduction of *Statement 34*, a CAFR should contain the MD&A, the Basic

[10] CAFR is "a Governmental Unit's official annual report prepared and published as a matter of public record. In addition to the general purpose external financial statements, the CAFR should contain introductory material, schedules to demonstrate legal compliance, and statistical tables specified in the GASB Codification" (Wilson and Kattelus, p. 686)

Financial Statement, and the RSI in the financial statements section in addition to introductory and statistical sections (Wilson and Kattelus 2002, p. 2).

> The current reporting model is not particularly effective at permitting users to evaluate issues relating to interperiod equity, assisting users in assessing a government's service efforts and accomplishments or helping users evaluate the financial condition of the government as a whole (Freeman and Shoulders, 2000, p. 10).

Auditor's Report

The Auditor's Report is not officially a required part of a *Statement 34* compliance CAFR, however, it provides an auditor's opinion as to the condition of an entity. The Auditor's Report is usually done by an independent CPA or audit agency, using the Generally Accepted Auditing Standards (GAAS).[11] Failure to adhere by the standards could lead an independent CPA or an audit agency to loose a license to practice, and it is the auditor's duty to adhere to the standards (Wilson and Kattelus 2002, p. 408). Even though the auditor's report section is not officially a part of *Statement 34*, it is highly recommended.

> In order for users of the financial statements to have the assurance that the statements are prepared in conformity with accounting and financial reporting standards…, the statements should be accompanied by the report of an independent auditor (Wilson and Kattelus 2002, p. 408).

The level of independence of an auditor is a serious issue with the introduction of S*tatement 34*. Many governments have relied on professional auditors to help implement *Statement 34*. The auditor acts in a combination role of preparer and attester, creating challenges to the independence of the audit process (Wallace, 2000, p. 192).

[11] Generally Accepted Auditing Standards (GAAS) is a "set of standards summarized by the [American Institute of Certified Public Accountants] AICPA and promulgated in Statements on Auditing Standards" (Wilson and Kattelus 2002, p. 408).

Management's Discussion and Analysis

The GASB's effort to provide adequate information for accountability purposes is, again, emphasized in the Management's Discussion and Analysis section. The Management's Discussion and Analysis (MD&A) is one of the three required parts of a *Statement 34* compliant CAFR required by *Statement 34*. This section was developed to provide easy to read and comprehensible information to legislators, oversight bodies, investors, and public in general (GASB, 1999, p. 1). It is a narrative discussion of key changes in financial position, management's analysis of such changes, and sharing of perspective as to the recurring or nonrecurring nature of observed shifts is cited as potentially of substantial value to users (Wallace, 2000, p. 180).

The governmental operation part of a CAFR provides financial reports in plain English to show governmental entities' financial situations (Hennen 2001, p. 2). "Financial managers might regard the MD&A as the *Cliffs Notes* of the government's financial and operational performance.[12] The MD&A should provide the reader with a thorough -- yet concise -- explanation of events, progress and change during the fiscal year" (Deon 2000, p. 2). The Management's Discussion and Analysis section is a culmination of the GASB's efforts to create easily readable narratives to stakeholders.

Basic Financial Statements

The Basic Financial Statements section is one of the three required parts of a *Statement 34* compliant CAFR, and the hallmark of the new standard. The section provides in-depth knowledge of inner operations of government entities by presenting

[12] MD&A: Management's Discussion and Analysis, which is one of the three requirements arising from the *Statement 34*.

two distinctive subsections: The Government Wide Statements and the Fund Financial Statements. This section previously only provided information using the *modified accrual method*. However, with the introduction of S*tatement 34*, the section provides two distinctive subsections, one for *operational accountability* and the other for *fiscal accountability*.

Government Wide Statements

Government Wide Statements include the following: a statement of net assets, and a statement of activities. A statement of net assets reports assets, liabilities and net assets based on the *accrual method* of accounting in a balance-sheet format.[13] The statement of Net Assets forces governmental entities to determine their asset value and offset it by their liabilities to show their economic resources (Hume, 2003, Vol. 343 p. 1). A statement of activities reports revenues and expenses based on the *accrual method* of accounting in a cash-flows statement format.[14] According to Hume, "[A statement of activities] focuses on activities and will describe major governmental programs and services, their costs, and the extent to which those costs are covered by self-generating fees, taxes, or other revenues" (2003, Vol. 343 p. 1). Both statements in the Government Wide Statements section provide *operational accountability*, which was previously not reported.

Despite the widely held notion that the government-wide statements depict previously missing information, some practitioners view this section with suspicion.

[13] The balance sheet "provides information about the nature and amounts of investments in enterprise resources, obligations to creditors, and the owners' equity in net resources" (Kieso et al 188).
[14] The cash flows statement "provides relevant information about the cash receipts and cash payments of an enterprise during a period" (Kieso et al 206).

Rose (2000, p. 18) maintains that government-wide statements do not show the social value of public programs and services. Any negative changes to the asset balance might be considered an unfavorable sign of financial crisis by certain people. Rose (2000, p. 18) contends, public services such as a senior citizens' center that have liabilities in excess of assets due to depreciation might be seen negatively despite the social value it brings to, not only senior citizens, but also all people associated with that center. Rose (2000, p. 18) argues that the government-wide statements overlook social worth of public projects.

Fund Financial Statements

Fund Financial Statements include the following: a Balance Sheet; a Statement of Revenues, Expenditures, and Changes in Fund Balances; a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Fund Net Assets; a Statement of Cash Flows; a Statement of Fiduciary Net Assets; and a Statement of Changes in Fiduciary Net Assets (Wilson and Kattelus 2002, p. 32).

The fund financial statements section depicts most of its information in the *accrual method* of accounting, but not all. Since a Balance Sheet and a Statement of Revenues, Expenditures, and Changes in Fund Balances are included in the governmental funds, they are reported using the *modified accrual method* (Wilson and Kattelus 2002, p. 42).[15] [16] Governmental activities are still reported using the *modified accrual method* to match revenues with expenses because *fiscal accountability* cannot be replaced by

[15] The accrual method of accounting: "recognizes revenue when it is earned and recognizes expenses in the period incurred, without regard to the time of receipt or payment of cash" (Kieso et al 98).
[16] The *modified accrual* method of accounting: "recognizes revenues only those inflows that are available to pay current-period obligations and recognizes as expenditures all obligations that will be paid from currently available financial resources" (Wilson and Kattelus 38).

operational accountability. Since a Statement of Net Assets; a Statement of Revenues, Expenses, and Changes in Fund Net Assets; and a Statement of Cash Flows are included in the proprietary funds, they are reported using the *accrual method* (Wilson and Kattelus 2002, p. 42). The proprietary funds use the *accrual method* because government entities need to be fully aware of the cost of such activities to make prudent business decisions. Lastly, since a Statement of Fiduciary Net Assets; and a Statement of Changes in Fiduciary Net Assets are included in the fiduciary funds, they are reported using the *accrual method* (Wilson and Kattelus 2002, p. 42).

The traditional statements using the *modified accrual method* depict *fiscal accountability*, but not *operational accountability* (Wilson and Kattelus 2002, p. 8). *Fiscal accountability* is "whether the government has raised and spent financial resources in accordance with budget plans and in compliance with pertinent laws and regulations" (Wilson and Kattelus 2002, p. 8). This ensures the use of funds for their intended purposes. On the contrary, o*perational accountability* is "whether the government has used resources efficiently" (Wilson and Kattelus 2002, p. 8). The efficient use of resources leads to interperiod equity. These two seemingly similar forms of accountability have completely different foci that require two different accounting methods, one is the *modified accrual*, which has always been in use for fund statements, and the other is full *accrual method*, which is the hallmark of *Statement 34*.

Table 3.1 Comparing types of accountability

Types of Accountability	Statements that depict respective accountability types	Accounting methods
Operational accountability	Government-wide statements	*Accrual* method
Fiscal accountability	Fund statements	*Modified accrual* method

Required Supplementary Information

The Required Supplementary Information (RSI) is one of the three required parts of a *Statement 34* compliant CAFR, which is comprised of additional information other than the Management's Discussion and Analysis. This section often contains budgetary comparison schedules with variances between adopted budgets and actual expenditures (Wilson and Kattelus 2002, p. 333). Such comparison can be used to assess *fiscal accountability* of public officials.

Usefulness of Information

A main focus of *Statement 34* is to provide easy-to-understand and useful information in the Management's Discussion and Analysis, the Basic Financial Statements, and the Required Supplementary Information section (Wilson and Kattelus 2002, p. 8). The second category, usefulness of information, is used as assessment criteria for *Statement 34*. This category is divided into three subcategories: citizens, decision-makers, and the municipal bond market. Those subcategories were chosen because of the GASB's focus on them. GASB (2002-2003 p. 1) claims that their mission is to establish and improve reporting standards that will result in useful information for the public, including issuers, auditors, and users of financial reports. Patton and Bean (2001, p. 33) declares that the users of financial statements are citizens, investors and creditors, and legislature and oversight bodies. Additionally, Tom Allen (2000, p. 70) supports Patton & Bean by recognizing that there are some people who should be users of financial statements, such as citizens and government officials.

Citizens

Previously, a Comprehensive Annual Financial Report (CAFR) did not provide information useful and understandable to a layperson. With the introduction of *Statement 34*, a CAFR is required to contain a Management's Discussion & Analysis (MD&A) section that is easily readable and comprehensible. The MD&A provides information on both *operational accountability* and *fiscal accountability* in a glance (Wilson and Kattelus 2002, p. 8). In addition, "For citizens, the more easily read government-wide statements provide a concise presentation of far more information than before on how elected officials are performing" (Kravchuk and Voorhees 2001, p. 29). Even those who may not be familiar with financial reporting can use the MD&A to learn details of government performance (Kravchuk and Voorhees 2001, p. 30). Chan (2001, p. 79-81) suggests higher level of public awareness of the magnitude of public debt due to such debt being displayed in basic financial statements.

Decision-makers

One of the arguments for the government-wide statements is that such reporting practice makes decision-makers aware of their long-term financial position (Wallace 2000, p. 198). Dillinger supports Wallace's position by commenting that an advantage associated with *Statement 34* is that with the government-wide statements, decision-makers have enhanced the ability to make long-range plans for capital improvements more quickly and efficiently. Information should facilitate long range planning because of its focus on *operational accountability*.

> An example might be found in the purchase of golf carts for a municipal golf course. 'The way government accounting works, the purchase is a one-year, six-figure expenses,'…But, in private accounting, the same assets would be depreciated over a

> number of years…This ability to take a long-range look at maintenance and capital needs may be a new experience for local governments and related entities that have been accountable only on a current-year basis, but it is one of the greatest benefits of *Statement 34* (Dillinger 2001, p. 4).

The United States has spent a considerable amount of money since the end of World War II on infrastructure, including highways, dams, water systems, and bridges (Cagle 2003, p. 1). Those investments required subsequent spending to maintain their conditions, and to prevent breakdown in the future. Despite obvious need, the expenditures needed to maintain infrastructure were susceptible to deferral. Infrastructure assets require continual development and funding.

On the contrary, some argue that expenditures on infrastructure are really sunk-costs, therefore expenditures on infrastructure should not have any effect on decision making by government officials.[17] "A common reaction to this situation is to treat the basic infrastructure as a sunk cost and concentrate on charging present and future generations for the costs associated with operation, maintenance, extension and upgrade" (McCrae 2000, p. 282).

Overall, government-wide financial statements provide choices to decision-makers that are more likely seen in the private sector, such as cutting costs, and increasing efficiency (Sacco 2000, p. 21). Decisions and costs can still be postponed to the future, but under *Statement 34*, those alternatives may be more difficult (Sacco 2000, p. 21). *Statement 34* compliant CAFRs display both favorable and unfavorable information upfront, where not only decision-makers, but also citizens are confronted with issues that otherwise would have been buried. Such presentation allows decision-makers to use the financial resources wisely to conduct government operations.

[17] Sunk cost is "a cost incurred in the past and not relevant to any future courses of action; the historical or past cost associated with the acquisition of an asset or a resource" (Barfield, Raiborn, and Kinney, p. G-13).

Municipal bond market

The municipal bond market provides important source of financing for local governments, which is evident by steadily increasing bonded debt of local governments. Despite its importance, financial reporting in the public sector, traditionally, did not focus on providing information to citizens and financial intermediaries (Kravchuk and Voorhees 2001, p.2). The market needs information on financial conditions of local governments to make prudent investment decisions. The information the market craves is now required by *Statement 34*.

State and local governments have two types of bonds. One is general obligation bond backed by the full faith of that entity. The other is a revenue bond backed by tangible assets that are constructed to create revenue. Mikesell (2003, p. 551) lists the following as main reasons for borrowing: higher education, elementary and secondary education, water supply, electric power, and gas supply transit.

According to Wilson and Kattelus (2001, p. 48), there are many participants in the municipal bond market, including, rating agencies, bond insurers, underwriters, dealers, brokers, financial advisors, accountants, and institutional and individual investors. Among the list of participants, rating analysts are considered as the most intensive users of local government financial information (Wilson and Kattelus 2001, p. 49). Despite differing intensities of needs, they are all interested in default risks.

In order to measure default risks, credit analysts use a set of standards to assess local governments' risk of default. The following are the assessment criteria used by credit analysts: statutory limits, debt margins, net G.O. dept per capita, overlapping debt per capita, the ratio of debt service expenditures to total expenditures, the political mood

and culture, such as the strength of taxpayer support for tax limitations or cuts, trends in real estate valuation, population, unemployment, and personal income (Wilson and Kattelus 2001, p. 53-54).

Financial intermediaries would benefit from the information provided on the government-wide statements using capitalization and depreciation (Kravchuk and Voorhees 2001, p. 29).

Accurate Representation

The accuracy of information provided in a Comprehensive Annual Financial Report (CAFR) is undoubtedly important. Without accurate information, even the most prudent investors, and well-informed citizens make decisions they otherwise would not have made with accurate information. The GASB's effort to make local government CAFRs more accurate in presentation has met with considerable resistance from the field. One of the controversies caused by *Statement 34* is its requirement to capitalize infrastructure, and another is depreciation of assets.

Capitalization of Infrastructure

Government officials have always known that capital assets depreciate in value due to wear and tear. Such loss of economic value is recorded in the private sector, but not in the public sector until the emergence of *Statement 34*. With the introduction of the new standard, investors are now able to acquire valuable information about economic resources of government entities. On the contrary, such information can be problematic. "Since debt comes onto the government-wide financial statements as liabilities, one could

virtually have a net liability outcome merely due to delay in introducing the associated infrastructure assets concurrently with the liability picture" (Wallace, 2000, p. 182). Presenting a negative value for net asset is a possibility under *Statement 34*.

Depreciation of Assets

Depreciation of assets is a standard procedure in the private sector. The Financial Accounting Standards Board requires publicly traded entities to account for, and report long-term assets using the historical cost minus accumulated depreciation.[18] [19] The GASB never imposed such requirements on government entities until the introduction of *Statement 34* (Hennen 2001, p. 1). This leads to accurate representation of values of assets, instead of valuing assets at their original cost without any depreciation. Allen asserts that, "there are two methods of infrastructure reporting allowed. One is the traditional approach in which depreciation expenses are subtracted from the cost of infrastructure. The other is a maintenance approach in which government entities responsible for infrastructure make necessary maintenance to keep the infrastructure's base" (2000, p. 73)

Historical Cost Method

The historical cost method involves taking a cost of an asset, developing an estimated useful life and its salvage value, then figuring the cost of asset per timeframe by subtracting the estimated salvage value from the cost, and then dividing the product

[18] Financial Accounting Standards Board is a private sector entity that is charged with the mission of providing accounting and reporting standards for the private sector.
[19] Accumulated depreciation is a contra asset account to depreciable assets such as buildings, machinery, and equipment (Hermanson, Edwards and Maher 1998, p. 151)

with its estimated useful life. The above-mentioned method is called straight-line depreciation, which is used by the City of Austin CAFR to calculate the depreciation of their assets.

Table 3.2 Straight-Line depreciation

	Total Cost
-	Salvage Value
	Depreciable Cost
/	Useful Life
	Depreciation Expense

Many governmental entities have never kept record of fixed assets. Therefore, accounting for value of such assets would pose a challenge (Johnson 1999, p. 3). Yet, measurement of existing assets is paramount to *Statement 34* (Dillinger 2001, p. 4). Wallace (2000, p. 182) expects some delay in implementing *Statement 34* due to complexity of determining historical costs of assets. Since book values were never recorded, governments are forced to infer values based on past maintenance expenses.

Modified Method

Statement 34 requires the use of the historical method to capitalize infrastructure. If information regarding the cost of infrastructure is not available, *Statement 34* allows the use of the modified approach (Robbins and Baldwin 2002, p. 5). The modified approach is also known as the preservation/maintenance approach, because it requires an establishment of an asset management system and requires entities to maintain their infrastructure assets at or above their specified conditions (Wallace 2000, p. 190).

Capitalization policy can have a significant influence on the difficulty of assessing the value of existing assets, and such policy needs to be established with

realistic assessment of available information (Chase 2001, p. 4). An unrealistic capitalization policy might have a significant impact on the cost of implementation.

Cost of Implementation

Cost of implementation is another criteria used to assess *Statement 34*. It was apparent that *Statement 34* would bring cost problems with implementation, even before the statement was issued (Patton and Bean 2001, p. 32). Kravchuk and Voorhees (2001, p. 30) agreed with Patton and Bean, that improvements in financial reporting come with substantial cost. "Implementing GASB Statement No. 34 requires a significant resource commitment from governments" (Wilson and Kattelus, 2001, p. 55). To introduce a contrary viewpoint, Freeman and Shoulders (2000, p. 10) agreed that there would be additional effort and cost to implement the new requirement. Nevertheless, they think the cost of implementation is not as bad as others think.

The survey of literature shows that there are three sub-categories that influence the cost of implementation; they are the human factors, new information technology equipment, and the government/creditor relationship.

Human Factors

The cost of implementing *Statement 34* is significantly influenced by human factors such as additional training, outside advises, and increased workload. One of the implications of *Statement 34* is that governments have to implement this standard without any expertise in the area and with very limited amounts of resources available to them (Cagle 2003, p. 1). Such limitations may add to the cost of hiring outside consultants or

auditing firms. To add to Cagle's point, Cote and Herron (2000, p. 30) suggests appointing at least two people to work on the implementation of *Statement 34*, which may increase the workload of other staff.

> Training that has both breadth and depth is crucial. First, the task force leaders should be trained on every aspect of the statement; this may include completing self-study and attending workshops and conferences. They will be the guidance counselors for others affected by this change. Next, the accounting staff implementing the changes should be trained. Finally, the oversight board will need user-friendly education so they can properly read, interpret and act on information they receive in this new format (Cote and Herron, 2000, p. 30).

Many local governments, especially small organizations, do not have much resource to divert to this effort. Engstrom and Tidrick (2001, p. 74) argue that there is anecdotal evidence that governments will keep their fund based accounting practice for now, and make spreadsheet adjustments to the fund based system to prepare government-wide statements. This could be a low cost method to adhere to the requirement. But, such conversion would surely be additional workload to employees. It is a daunting task to convert fund financial statement using the *modified accrual method* to government-wide statements with a different focus (Allison 2001, p. 17).

Information System

The next subcategory for the cost of implementation is information system, specifically Accounting Information System. "The accounting information system is a specialized subsystem of the MIS [Management Information System]. Its purpose is to collect, process, and report information related to financial aspects of business events" (Gelinas and Sutton 2002, p. 14). Accounting Information System (AIS) is beyond the scope of this research. Therefore, AIS will not be covered in detail.

Although, *Statement 34* does not require acquisition of new information systems, Sigo, and Rendleman recommend or talk positively of their experience with IT acquisition. Governmental entities may continue to use their existing accounting software for the time being, and convert their financial information at the end of a fiscal year with a spreadsheet to government-wide form to comply with the new requirement (Wilson and Kattelus 2001, p. 59). They do not discourage the use of existing software, but they mention the possibility of investing in new software in the future.

The Government/Creditor Relationship

The implementation of *Statement 34* poses a possibility of local governments incurring indirect costs such as lower bond ratings, and higher cost of financing in the future. Local governments may have to forgo their current credit ratings to implement *Statement 34*, which might lower their credit ratings. Lower credit ratings triggers higher cost of borrowing in the future. Such cost may be considered as an opportunity cost of implementing *Statement 34*.[20]

Possible complications arising from the new standard are downgrading of bonds, and difficulties that municipalities may face in the future from higher borrowing cost (Hume 2003, p. 2). The complications mentioned above might cost governmental entities in the future, if or when they wish to issue additional bonds to finance their operations. As long as state and local governments try to obtain auditors' clean opinions, they will have to stay within the framework of standards established by GASB. Chan (2001, p. 83) claims, "GASB standards are recognized by the auditing profession and the financial

[20] Opportunity cost is a value of the best alternative that had to be forgone in order to undertake a given course of action (Wessels 2000, p. 1)

market as the benchmark for evaluating the accounting practices of individual jurisdictions." Hennen argues that the new standard will require state and local governments to report more accurate health of their finances. "The new audit rules also will shine a spotlight on a community's poor planning and cost it dearly when municipal bonds are rated. Lower ratings mean municipalities must pay higher interest to borrow money for future projects" (Hennen 2001, p. 2). Wilson and Kattelus (2001, p. 56) have even harsher statements to state and local governments, that governmental entities that do not conform to *Statement 34* in entirety may face bond-rating agencies adversely rating them for not complying with GASB standards.

In a contrary view, "despite the introduction of the new standard, the debt ratings of municipalities are not likely to change" (Hume 2003, vol. 343 p. 1). Hume (2003, vol. 343 p.2) maintains that if municipalities' main reason for noncompliance were the cost of compliance outweighing the benefits, then the ratings of those governmental entities would not change. However, if their noncompliance were because of weak management, their ratings would suffer. Municipalities that decide to comply or not to comply with the new regulation will have little or no change to their ratings. Nonetheless, those municipalities that opt out of the new requirement may face higher borrowing costs (2003, Vol. 343 p. 1).

> The government-wide information should make a governmental unit's financial viability more apparent to readers. Moreover, financial statement readers will clearly see the large investments in infrastructures of governments that have seldom been reported in current practice. The changes are intended to meet unfilled needs of users based on extensive due process. Will the new model bring more users into the fold? Only the full light of the sun will tell (Johnson and Bean 1999, p. 1).

Despite arguments suggesting possible grave impact on bond-ratings, Kravchuk and Voorhees (2001, p. 3) claim that governmental entities may benefit from reduced cost of

borrowing due to enhanced communication of financial conditions between governments and financial intermediaries.

Linking Conceptual Framework to Literature

The research employs descriptive categories as the conceptual framework. According to Dr. Shields, "Many students do attitudinal survey research. Often the best or only literature available on these topics consists of expert-opinion. The student's challenge is to take the vast array of opinion and organize it into categories." Expert opinions are categorized into several bins to explore the perceptions of public finance officials in a more organized manner. The following literature provides support for the four broad categories used to conceptualize the research purpose.

Table 3.3
Descriptive categories for *Statement* 34

Categories	Literature
Adequacy and Accountability of Financial Statements	
The Auditor's Report provides adequate information	Wilson and Kattelus (2002), Wallace (2000)
The Management's Discussion & Analysis section provides adequate information	Deon (2000), GASB (1999), Wallace (2000), Hennen (2001)
The Basic Financial Statement provides adequate information	Wilson and Kattelus (2002), Hume (2003), Rose (2000)
The Required Supplementary Information section provides adequate information	Wilson and Kattelus (2002)

Useful Information The new standard provides useful information to citizens	Wilson and Kattelus (2002), Chan (2001), Kravchuk and Voorhees (2001), Allen (2000)
The new standard provides useful information to decision-makers	Dillinger (2001), Cagle (2002), McCrae (2000), Wallace (2000), Sacco (2000)
The new standard provides useful information to the municipal bond market	Wilson and Kattelus (2001), Kravchuk and Voorhees (2001), Mikesell (2003)
Accurate Representation Capitalization of assets is needed to accurately represent financial situations	Wallace (2000)
Depreciation of assets is needed to accurately represent financial situations	Johnson(1999), Dillinger (2001), Robbins and Baldwin (2002), Chase (2001), Allen (2001), Hennen (2001), Wallace (2000)
Cost of Implementation Human factors	Patton and Bean (2001), Kravchuk and Voorhees (2001), Allison (2001), Cagle (2003), Wilson and Kattelus (2001), Freeman and Shoulders (2000), Cote and Herron (2000), Engstrom and Tidrick (2001)
Information technology equipments	Sigo (2001), Wilson and Kattelus (2001), Gelinas and Sutton (2002)
The government/creditor relationship	Hume (2003), Hennen (2001), Chan (2000), Wilson and Kattelus (2001), Kravchuk and Voorhees (2001), Johnson and Bean (1999)

Chapter Four – Methodology

Introduction

The purpose of this chapter is to describe the methodology used to address the research purpose. As previously mentioned in the Introduction Chapter, the purpose of this research is to describe public finance officials' assessment of the characteristics of *Statement 34* on local governments in Texas. In this chapter, the conceptual framework, which is the four descriptive categories, is operationalized by deriving survey questions that connect the conceptual framework to the public finance officials' assessment. "Categories are intuitively appealing because they are easily linked to the familiar 'Survey Research' (Shields 1998, p. 218). The descriptive categories are the following: adequacy and accountability of financial statements, usefulness of information, accurate representation, and cost of implementation.

Survey Research

The research surveyed one-hundred public finance officials in Texas about *Statement 34*. The surveys were sent out on 6 October 2003. The research used envelopes with a questionnaire and a letter stating the purpose of the research in each envelope. This research method was chosen because the research is descriptive in nature and finding attitudes and perception is the focus of the research. According to Babbie (2001, p. 238), "surveys are… excellent vehicles for measuring attitudes and orientations in a large population."

Survey as a mode of observation has its strengths and weaknesses. The strengths include the ability to use large samples, flexibility in analysis, and standardization of

questions. The weaknesses include: the requirement to standardize the questionnaire, which is tailored to the lowest common denominator instead of focusing on the most appropriate respondents; the distance between the survey researcher and the study subject; its inflexibility in adopting to new circumstances; and its artificiality which only records what respondents recall of certain incidents or what they plan to do or a hypothetical situation. In addition, Babbie states "survey research is generally weak on validity and strong on reliability."

The problems of survey research mentioned above are addressed in the following: First, since the research purpose is to describe public finance officials' assessment of the characteristics of *Statement 34* on local governments in Texas, the survey instrument is tailored to public finance officials who are already familiar with *Statement 34*. The directory of public finance officials obtained from the Government Finance Officers Association of Texas is a group of appropriate respondents. Second, the distance between the survey researcher and respondents is a problem. Nevertheless, the directory of public finance officials in Texas contains not only phone numbers, but also e-mail addresses, fax numbers, and mailing addresses as well. In addition, the directory was published on the 7 July 2003. The quality of contact information remedies the potential problem with distance. Third, even though survey instruments are inflexible, the analysis following the collection of information is flexible. Lastly, artificiality is not a problem in this case because the focus of this research is attitudes and perceptions, not the absolute truth.

Linking the survey questions to descriptive categories

The survey questions are directly derived from descriptive categories of the conceptual framework. "Categories as an explicit conceptual tool have considerable applicability because they give questionnaires a conceptual frame work" (Shields 1998, p. 218). The first category of questions (see Table 4.1) explores the perceptions and attitudes of public finance officials about the Auditor's report, the Management's Discussion and Analysis, the Basic Financial Statements, and the Required Supplementary Information on two different types of accountability, *fiscal accountability* and *operational accountability*. The second category of questions explores the perceptions of public finance officials about the usefulness of *Statement 34* information to citizens, decision makers and bondholders. The questions of the third category explore the details of changes required by *Statement 34* including capitalization, depreciation, the *accrual method* and the *modified accrual*. The literature on the information of these changes reveals a disparity of perception. The fourth category explores the perceptions of public finance officials on the cost of implementation of the new standard. The cost of implementation issues are measured on three major points: human factors, information technology, and the government/creditor relationship.

Table 4.1
Operationalizing the Conceptual Framework

Categories	Survey Questions
Adequate Information for accountability The Auditor's Report provides adequate information	SQ 1: The Auditor's Report provides adequate information on *fiscal accountability*, meaning matching of revenues with expenses SQ 2: The Auditor's Report provides adequate information on *operational accountability* (inter-period equity)

The Management's Discussion & Analysis section provides adequate information	SQ 3: The Management's Discussion & Analysis section provides adequate information on *fiscal accountability* SQ 4: The Management's Discussion & Analysis section provides adequate information on *operational accountability*
The Basic Financial Statement provides adequate information	SQ 5: The Basic Financial Statement section provides adequate information on *fiscal accountability* SQ 6: The Basic Financial Statement section provides adequate information on *operational accountability*
The Required Supplementary Information section provides adequate information	SQ 7: The Required Supplementary Information section provides adequate information on *fiscal accountability* SQ 8: The Required Supplementary Information section provides adequate information on *operational accountability*
Useful Information The new standard provides useful information to citizens	SQ 9: The new standard provides easily readable and comprehensible information to citizens for their use.
The new standard provides useful information to decision-makers	SQ 10: The new standard provides easily readable and comprehensible information to decision-makers for their use.
The new standard provides useful information to the municipal bond market	SQ 11: The new standard provides easily readable and comprehensible information to bondholders for their use
Accurate Representation Capitalization of assets is needed to accurately represent financial situations	SQ 12: Capitalization of infrastructure is needed to provide better view of financial situation
Depreciation of assets is needed to accurately represent financial situations	SQ 13: Depreciation of assets is needed to provide better view of financial situation

Cost of Implementation Human factors	SQ 14: A larger staff size is needed to accommodate the new standard. SQ 15: The new standard increases the workload SQ 16: The new standard may require additional employee training
Information technology equipments	SQ 17: The new standard may require new information technology hardware SQ 18: The new standard may require new information technology software SQ 19: The IT spending may rise due to the new standard
The government/creditor relationship	SQ 20: The bond ratings of municipalities will suffer SQ 21: It will be more difficult to finance large projects in the future

Sample

The population of the survey research is 799 current members of the Government Finance Officers Association of Texas obtained from the association's website. The Government Finance Officers Association of Texas (GFOAT) is an affiliate of the Texas Municipal League, which serves cities and towns in Texas with variety of services. According to the Government Finance Officers Association of Texas, their mission statement is "to enhance the quality of local government finance, to assist and support local government finance professionals in Texas, and to promote the public service profession." The unique focus of the GFOAT corresponds with the research purpose of

this study: to describe public finance officials' assessment of the characteristics of *Statement 34* on local governments in Texas.

The sample of One-hundred was systematically chosen from the list of financial officials working for or with local governments in Texas. The first number was chosen from the first number in the random number table in Babbie's *The Practice of Social Research*, and then the researcher surveyed every eighth person in the GFOAT directory mentioned above.

Statistics

The research employs descriptive-statistics to show the mode and percentage of respondents answering Strongly Agree and Agree collapsed into one number for each survey question. This method allows readers to see the most occurring perception, which in this case is mode, and the consensus of the sample in the results chapter.

Chapter Five – Results

Introduction

The purpose of this study is to describe the public finance officials' assessment of the characteristics of the new standard, *Statement 34* by the GASB on local governments in Texas. This chapter employs descriptive categories derived from literature review to organize and present the results of this study. Twenty-three of the one-hundred public finance professionals reported to the survey, with two of them electing not to provide their opinions because they were in the process of implementing *Statement 34*. The surveys were sent to prospective participants on 6 October 2003, and the response rate for the survey was twenty-three percent.

Adequacy and Accountability of Financial Statements

Table 5.1 Adequacy and Accountability of Financial Statements

Survey Questions	N	% Strongly agree & Agree	Mode
The Auditor's Report provides adequate information on *fiscal accountability*	21	81%	Agree
The Auditor's Report provides adequate information on *operational accountability*	20	65%	Agree
The Management's Discussion & Analysis section provides adequate information on *fiscal accountability*	21	81%	Agree
The Management's Discussion & Analysis section provides adequate information on *operational accountability*	21	81%	Agree
The Basic Financial Statement provides adequate information on *fiscal accountability*	21	86%	Agree
The Basic Financial Statement provides adequate information on *operational accountability*	21	67%	Agree
The Required Supplementary Information section provides adequate information on *fiscal accountability*	21	67%	Agree
The Required Supplementary Information section provides adequate information on *operational accountability*	21	43%	Agree

Auditor's report

A majority (52%) of the survey respondents agreed with a statement that the Auditor's Report provides adequate information on *fiscal accountability*. In addition, about a quarter (29%) of the respondents strongly agreed with that statement. Even though the Auditor's Report is usually a very small document, practitioners seem to value the document.

One of the major reasons behind the making of *Statement 34* was the need for *operational accountability* in the public sector. Before *Statement 34*, state and local governments' annual financial statements did not have any information regarding *operational accountability*. Rather, they concentrated on *fiscal accountability.* With the introduction of *Statement 34*, *operational accountability* became an integral part of annual financial statements. A majority (65%) of the respondents either agreed or strongly agreed that Auditor's Report provides adequate information on *operational accountability*.

Management's Discussion and Analysis

An overwhelming majority (81%) of the respondents believe that the Management's Discussion & Analysis section provides adequate information on *fiscal accountability*. This is one of the sections created by *Statement 34,* which is supposed to be written in such a way that a layperson can understand. The data shows that there is a consensus among public finance professionals in Texas that this section is of value especially when *fiscal accountability* is in question.

The statistics show that public finance professionals in Texas have very similar attitudes on the Management's Discussion & Analysis section, whether the focus is on

fiscal accountability, or *operational accountability*. Again, an overwhelming majority (81%) of public finance professionals in Texas believe that the Management's Discussion & Analysis section provides adequate information on *operational accountability*. The data strongly supports the value of the Management's Discussion & Analysis, which is a corporation style report designed for average citizens.

Basic Financial Statements

Almost all respondents (85%) agreed or strongly agreed that the Basic Financial Statement provides adequate information on *fiscal accountability*. The data shows that no one disagreed. The basic financial statement is the main part of any annual financial statement, where all financial operations are disclosed to the public with excruciating details.

With the introduction of *Statement 34*, the basic financial section of annual financial statements was heavily modified. The GASB decided to keep fund accounting for *fiscal accountability*, and added the *accrual method* of accounting for *operational accountability*. Before *Statement 34*, the basic financial section of annual financial statements did not present enough information. It only presented information for *fiscal accountability* purpose. In order to create annual financial statements that carry information on both fiscal and *operational accountability*, the GASB introduced the *accrual method* of accounting to the public sector. A majority of respondents (67%) agreed that the basic financial statement provides adequate information on *operational accountability*.

Required Supplementary Information

An overwhelming majority (67%) of respondents agreed that the Required Supplementary Information (RSI) section provides adequate information on *fiscal accountability*. This depends on what type of information is presented in the section. Since the RSI section tends to carry a budgetary comparison schedule, it makes sense to see such consensus among finance professionals. On the contrary, the Public Finance Professionals' perception on whether the Required Supplementary Information section provides adequate information on *operational accountability* is mixed. A few respondents had strongly agreed (5%) or strongly disagreed (5%). Most respondents (90%) had mediocre response to whether the RSI section avails information on *operational accountability*.

Usefulness of Information

Table 5.2 Usefulness of Information

Survey Questions	N	% Strongly agree & Agree	Mode
The new standard provides easily readable and comprehensible information to citizens for their use	21	19%	Strongly disagree
The new standard provides easily readable and comprehensible information to decision-makers for their use	21	43%	Agree
The new standard provides easily readable and comprehensible information to bond holders for their use	21	57%	Agree

Citizens

Despite the GASB's effort to make financial statements easily readable by average citizens, a majority of respondents (62%) either disagreed or strongly disagreed with a statement that the new standard provides easily readable and comprehensible

information to citizens for their use. According to the table above, most public finance officials agreed that the changes made by *Statement 34* provide adequate information. Nevertheless, public finance officials seem to think that even though *Statement 34* compliant financial statements carry adequate amount of information, it is not easily readable by citizens. This consensus is an alarming perception held by public finance officials about the equity of *Statement 34*.

Decision-Makers

According to the GASB, the GASB primarily creates standard for two different groups: decision-makers and users of financial statements, including citizens, bondholders, etc. Despite their intent to serve users of financial statements, along with decision-makers, a slightly less than a majority of respondents (43%) think that *Statement 34* compliant financial statements do not provide easily readable and comprehensible information to decision-makers. On the other hand, approximately the same number of respondents (43%) agreed that the new standard provides easily readable and comprehensible information to decision-makers. The public finance officials' attitudes about readability and comprehensibility of information to decision-makers are highly polarized to an extent where interpretation of the mean score may not be appropriate.

The Municipal Bond Market

A majority of respondents (57%) believes that the new standard provides easily readable and comprehensible information to the municipal bond market for their use. Public finance officials have a favorable view on readability and comprehensibility of information to the municipal bond market, which is remarkably different from their attitudes about readability and comprehensibility of information to citizens. This data

shows that public finance officials have a favorable view of the level of knowledge that the market has. To put it differently, the result shows that there is a consensus that financial statements by state and local governments are really marketed toward the investment community rather than the public.

Approximately, one-third of respondents disagreed with readability and comprehensibility of information even to the municipal bond market. Despite their sophisticated analysis tools, some public finance officials think that the new standard is still not meeting the needs of some people.

Accurate Representation

Table 5.3 Accurate Representation

Survey Questions	N	% Strongly agree & Agree	Mode
Capitalization of assets is needed to accurately represent financial situations	21	38%	Disagree
Depreciation of assets is needed to accurately represent financial situations	21	43%	Agree

Capitalization of Infrastructure

There is no consensus among public finance officials in Texas about the needs to capitalize infrastructure assets. On average, public finance officials neither agreed nor disagreed with a statement that capitalization of infrastructure is needed to provide better view of financial situation. However, when standard deviation is this high compared to the mean score, there is a question as to the meaning of the mean score. In addition, the number of respondents who answered, “Neither agree nor disagree” dips below those people who agreed or disagreed. Again, the opinion is polarized. According to one of

the survey respondents, *Statement 34* grossly overstates fund balance by taking unrecognized gains into account. The survey respondent agreed to such information being collected. However, the respondent thought that such amount should not be represented in the combined section of the financials due to overstatement of fund balance.

Depreciation

The depreciation of infrastructure assets is one of the major requirements of *Statement 34*. The *statement* requires state and local governments to use the historical cost method to account for infrastructure assets, except when the modified method is elected. The modified method requires an asset management system along with periodic maintenance, which can be expensive. According to one of the survey respondents, the North Texas Toll way has adopted the modified method to account for infrastructure assets despite its drawback in maintenance costs. The adoption of the modified method at their maintenance level had a dramatic budgetary impact, where multi-million dollars had to be added to their FY 2004 budget.

On the other hand, the historical method is the method of choice by the private sector. This method depreciates assets at a predetermined rate established by their accounting policy. When an asset is depreciated to its salvage value, it is time for replacement. There are several different approaches to depreciation of assets when the historical cost method is elected: double declining method, sum of the year's digit method, straight-line method, and the effective interest method.

The table above shows that public finance officials in Texas do not have a consensus about the capitalization issue. The opinion is polarized.

Cost of Implementation

Table 5.4 Cost of Implementation

Survey Questions	N	% Strongly agree & Agree	Mode
A larger staff size is needed to accommodate the new standard	21	38%	Disagree
The new standard increases the workload	21	81%	Strongly agree
The new standard may require additional employee training	21	90%	Strongly agree
The new standard may require new information technology hardware	21	43%	Neither agree or disagree
The new standard may require new information technology software	21	52%	Agree
The IT spending may rise due to the new standard	21	48%	Strongly agree
The bond ratings of municipalities will suffer	21	5%	Disagree
It will be more difficult to finance large projects in the future	21	10%	Disagree

Human Factors

The table shows mixed signals on the need to increase staff size to accommodate *Statement 34*. Approximately one-third of respondents (38%) agreed or strongly agreed that a larger staff size is needed to accommodate the new standard. On the other hand, approximately the same number of respondents (43%) disagreed or strongly disagreed with the need to hire additional personnel to accommodate the new standard. According to the survey, many municipalities were in the process of implementing *Statement 34*. Consequently, they were not aware of the full cost of implementation at the time of survey.

The table above shows that almost all respondents (81%) agreed that the new standard increases the workload. According to one of the survey respondents, the benefits of implementation are hugely overweighed by its costs. The respondent believed that the end product would not be anymore comprehensible than its predecessor. Another respondent stated, "I do not believe the benefits received from this model outweigh the costs associated with producing the report." Yet another respondent argued, "GASB 34 requires more work with no value. Greatly increases cost of annual audit." Additionally, due to the dramatic change in the reporting standard, the competency of employees became an issue. Almost all respondents (90%) agreed that the new standard might require additional employee training.

Information Technology Equipments

Slightly less than a majority of respondents (43%) agreed that the new standard might require new information technology hardware. Approximately one-third of respondents neither agreed nor disagreed. In addition, a majority (53%) of public finance officials believe that there is a need to acquire new information technology software to process higher volume of information. Thus, almost a majority of respondents (48%) agreed that the IT spending might rise due to *Statement 34*.

The Government/Creditor Relationship

A majority (57%) of public finance officials believe that the bond ratings of municipalities would not suffer from *Statement 34*. Still, approximately one-third of respondents (38%) were unsure as to the direction of bond rating. At the time of the survey, some municipalities had not completed implementing Statement 34. Therefore, the impact on bond ratings was unknown to many public finance officials.

There is a consensus (67%) among public finance officials in Texas that *Statement 34* will not make it anymore difficult to finance large projects in the future. A majority of them is optimistic about financing of large projects in the future, with only one respondent taking a position different from the majority.

Research Results

The research results show that there is strong evidence that *Statement 34* compliant financial statements provide adequate information for *fiscal accountability* and *operational accountability*. Yet, the same results show that even though adequate amount of information is distributed, there is a consensus among public finance officials that the statements themselves are not easily readable or comprehensible to citizens. Additionally, there was a mixed opinion among public finance officials about the usefulness of such information to decision-makers.

The cost of implementation seems to be the biggest concern among public finance officials in Texas. The respondents were concerned about the increased workload, and additional employee training required in accommodating the complexity arising from *Statement 34*. Many respondents were concerned about their IT equipments as well. Overall, public finance officials in Texas agreed that the implementation would be costly. Again, many municipalities in Texas had not fully implemented *Statement 34* at the time of survey. Consequently, the full cost of implementation was largely unknown at the time. Despite possible rise in the cost of borrowing in the future, a majority of public finance officials in Texas were not concerned about bond ratings, possibly due to prudent financial management in the past.

Chapter Six – Conclusions

Introduction

The purpose of this study is to describe public finance officials' perceptions about the characteristics of the new standard, *Statement 34* on local governments in Texas. This chapter summarizes the results of this study by organizing all survey questions into four categories previously mentioned in Chapter Four – Methodology. The categories are the following: Adequacy and Accountability of Financial Statements, Useful Information, Accurate Representation, and Cost of Implementation.

Conclusions

Table 6.1 Categories & Support

	Categories	Mode
1	Adequacy and Accountability of Financial Statements	Agree
2	Useful Information	Agree
3	Accurate Representation	Neither agree or disagree
4	Cost of Implementation	Strongly agree on cost & Disagree on financing cost

1. Public finance officials in Texas agree that the three new components required by *Statement 34*, namely, the Auditor's Report, the Management's Discussion & Analysis, and the Required Supplementary Information provide adequate amount of information for *fiscal accountability* and *operational accountability*. The consensus among public finance officials shows that *Statement 34* has accomplished one of the major missions of *Statement 34*.

2. Public finance officials in Texas have not come to a consensus on usefulness of *Statement 34* compliant financial statements: the opinions are polarized. Specifically, public finance officials in Texas agreed that *Statement 34* compliant financial statements are useful to the municipal bond market, partially useful to decision-makers, and not very useful to the citizenry. One of the main purposes of *Statement 34* is to require state and local governments to produce easily comprehensible financial statements. The research results show that public finance officials in Texas think that this mission is partially accomplished, except for the usefulness to the citizenry.
3. Public finance officials in Texas have not come to a consensus on efficacy of infrastructure capitalization and depreciation of assets. Highly polarized data makes it hard to infer any conclusion. Nevertheless, a number of survey respondents wrote comments on difficulties arising from capitalization and depreciation.
4. Public finance officials in Texas expect high cost of implementation in an initial stage of implementation, but expect no negative effect on their ability to finance operations in the future. They particularly agreed about increased workload, and additional employee training, and new information technology equipments needed to accommodate the complexity arising from *Statement 34*.

Limitations

The research is limited in its external and internal validity. Since the research concentrated on the attitudes and perceptions of public finance officials in Texas about

Statement 34, there can be no generalization of the findings to other regions of the country. Since many municipalities were still in the process of implementing *Statement 34*, the researcher could not obtain concrete figures as to the cost of implementation. Since there was no pretest of attitudes and perceptions, there is a significant problem with the threat of history. Since there was no randomization of assignment, the threat of history is even greater. In addition, the threat of selection bias is a significant threat to the internal validity of this research due to its low survey response rate (23%).

Recommendations

Governmental accounting standards define the way information should be presented to citizens, decision-makers, and the municipal bond market. In addition, governmental accounting standards define the way information should be processed. Accurate representation and adequate disclosure of municipal finances that are useful to interested parties are of concern to many people. Nonetheless, governmental accounting standards' effects on local governments is an area of study that has not been well researched in the past.

Recommendations for future studies include the use of a more rigorous research design, a larger survey sample, an expansion of study population, and further analyses of cost of implementation including information technology and government/creditor relationship.

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Appendix A – Sample survey

7707 S. IH35 Apt 415
Austin, TX 78744
(254) 371-4335

5 October 2003

Inside Address

Dear Sir or Madam

Subject: GASB 34 survey

I am a student at Texas State University – San Marcos, pursuing a degree in public administration. In order to partially fulfill the graduation requirement, I am surveying public finance professionals regarding the impact of GASB 34 by the Governmental Accounting Standard Board. If I understand correctly, GASB 34 changed the way state and local governments conduct financial reporting.

I have enclosed a 21 questions survey with this letter hoping that you would help me explore the impact of the change in regulation.

Thank you in advance for your valuable help.

Sincerely,

Keiji Shirota.

Enclosure (2)

Closed end survey for public finance professionals

This is a closed end survey distributed to public finance professionals. The purpose of this study is to describe the perceptions of public finance officials about the characteristics of the GASB Statement No. 34 by the Governmental Accounting Standards Board on state and local governments in Texas.

1. Strongly agree
2. Agree
3. Neither agree or disagree
4. Disagree
5. Strongly disagree

(Real number of respondents)
Please circle a number

	1	2	3	4	5
SQ 1: The Auditor's Report provides adequate information on *fiscal accountability*, meaning matching of revenues with expenses	(6)	(11)	(2)	(1)	(1)
SQ 2: The Auditor's Report provides adequate information on *operational accountability* (inter-period equity)	(2)	(11)	(3)	(3)	(1)
SQ 3: The Management's Discussion & Analysis section provides adequate information on *fiscal accountability*	(5)	(12)	(3)	(1)	(0)
SQ 4: The Management's Discussion & Analysis section provides adequate information on *operational accountability*	(5)	(12)	(3)	(1)	(0)
SQ 5: The Basic Financial Statement section provides adequate information on *fiscal accountability*	(7)	(11)	(3)	(0)	(0)
SQ 6: The Basic Financial Statement section provides adequate information on *operational accountability*	(4)	(10)	(4)	(3)	(0)
SQ 7: The Required Supplementary Information section provides adequate information on *fiscal accountability*	(2)	(12)	(3)	(3)	(1)

	1	2	3	4	5
SQ 8: The Required Supplementary Information section provides adequate information on *operational accountability*	(1)	(8)	(6)	(5)	(1)
SQ 9: The new standard provides easily readable and comprehensible information to citizens for their use.	(1)	(3)	(4)	(6)	(7)
SQ 10: The new standard provides easily readable and comprehensible information to decision-makers for their use.	(1)	(8)	(3)	(5)	(4)
SQ 11: The new standard provides easily readable and comprehensible information to bond holders for their use	(1)	(11)	(2)	(4)	(3)
SQ 12: Capitalization of infrastructure is needed to provide better view of financial situation	(3)	(5)	(3)	(7)	(3)
SQ 13: Depreciation of assets is needed to provide better view of financial situation	(3)	(6)	(4)	(5)	(3)
SQ 14: A larger staff size is needed to accommodate the new standard.	(5)	(3)	(4)	(8)	(1)
SQ 15: The new standard increases the workload	(11)	(6)	(3)	(1)	(0)
SQ 16: The new standard may require additional employee training	(15)	(4)	(1)	(1)	(0)
SQ 17: The new standard may require new information technology hardware	(5)	(4)	(7)	(5)	(0)
SQ 18: The new standard may require new information technology software	(5)	(6)	(5)	(5)	(0)
SQ 19: The IT spending may rise due to the new standard	(6)	(4)	(5)	(5)	(1)
SQ 20: The bond ratings of municipalities will suffer	(1)	(0)	(8)	(9)	(3)
SQ 21: It will be more difficult to finance large projects in the future	(0)	(2)	(5)	(12)	(2)

This section is optional

This section supplements the survey above to remedy the inflexible nature of a closed end survey. If there were any comments you would like to make, please feel free to write them down on this sheet of paper. Thank you for your cooperation.

Appendix B – A list of GFOAT members surveyed

City	Title	Organization
Arlington	St. Manager Finance	Trinity River Authority
Arlington	Senior Accountant	North Central Texas COG
Athens	Director of Finance	City of Athens
Austin	Assistant Budget Director	City of Austin
Austin	Regional Manager	Great-West/Benefits Corp
Austin	Field Services Manager	TML Intergovernmental Risk Pool
Austin	Treasurer	City of Austin
Balch Springs	Accounting Director	City of Balch Springs
Baytown	Treasurer	City o Baytown PO Box 424
Benbrook	Controller	Benbrook Water & Sewer Authority
Boerne	Assistant Director of Finance	City of Boerne
Brownsville	Chief Financial Officer	Brownsville Public Utilities Board
Brownwood	Director of Finance	City of Brownwood
Bryan	Finance Officer	City of Bryan
Canadian	Officer Manager	City of Canadian
Comanche	City Secretary	City of Comanche
Conroe	Assistant City Administrator	City of Conroe
Coppell	Director of Finance	City of Coppell
Coppell	Assistant Director of Finance	City of Coppell
Corpus Christi	Assistant Director of Aviation	Corpus Christi International Airport
Corsicana	Director of Finance	City of Corsicana
Dallas	Vice President	Southwest Securities Inc
Dallas	City Controller	City of Dallas
Dallas	Senior Vice President	First Southwest Company
Dallas	Sr. Accountant - Financial Reporting	City of Dallas
Dallas	VP/Director of Marketing	LOGIC
Dallas	Controller/Systems Administrator	Town of Highland Park
Dallas	Account Manager	American Appraisal Associates
Decatur	Accounting/HR Specialist	City of Decatur
Deer Park	Senior Accountant	City of Deer Park
Denison	Director of Finance	City of Denison
Denton	Cash & Debt Administrator	City of Denton
Denver	Vice President	MBIA Municipal Investors Service Corp
De Soto	Mng Dir Fiscal & Human Svcs	City of De Soto
Diamond Bar	President	The HDL Companies
Fort Worth	Senior Vice President/Manager Public	Chase Bank of Texas
Fort Worth	Senior Consultant	Government Resource Associates
Fredericksburg	Director of Finance	City of Fredericksburg
Friendswood	Director of Admin Services	City of Friendswood
Frisco	Director of Administrative Services	City of Frisco
Graham	Finance Director	City of Graham

Granbury	Assistant Finance Director	City of Granbury
Haltom City	Director of Finance	City of Haltom City
Hillsboro	Finance/HR Director	City of Hillsboro
Houston	Audit Supervisor	Null-Lairson, PC
Houston	Manager, Financial Services	Gulf Coast Waste Disposal Authority
Houston	Vice President	Duncan-Williams, Inc
Hughes Springs		
Hurst	Assistant Director of Finance	City of Hurst
Irving	Budget Analyst	City of Irving
Irving	Senior Accountant	City of Irving
Kerrville	Administrative & Financial Services	Upper Guadalupe River Authority
Kerrville	Assistant City Manager	City of Kerrville
Kirby	Finance Director	City of Kirby
La Porte	Assistant Finance Director	City of La Porte
Lewisville	Accounting and Audit Manager	City of Lewisville
Little Rock	Vice President	Stephens Inc
Lockhart	Finance Director	City of Lockhart
Los Fresnos	Finance Director	City of Los Fresnos
Lubbock	Communications Coordinator	City of Lubbock
Lubbock	Senior Auditor	City of Lubbock
Lubbock	Chief Accountant	City of Lubbock
Lubbock	Budget Analyst	City of Lubbock
McKinney	Director of Finance	City of McKinney
Mesquite	Cash & Debt Coordinator	City of Mesquite
Midland	Assistant City Manager	City of Midland
Missouri City	Director of Finance	City of Missouri City
North Richland Hills	Budget Analyst	City of North Richland Hills
Pasadena	Accounting Manager	City of Pasadena
Plano	Director of Finance	North Texas Tollway Authority
Plano	Accountant II	City of Plano
Plano	Director of Finance	City of Plano
Plano	Assistant Director of Finance	North Texas Tollway Authority
Richardson	Director of Finance	City of Richardson
Richardson	Accountant	City of Richardson
Richardson	Assistant Director of Finance	City of Richardson
Rowlett	Budget Officer	City of Rowlett
San Angelo	Accountant	City of San Angelo
San Marcos	Assistant Director of Finance / Controller	City of San Marcos
Seminole	Director of Finance	City of Seminole
Snyder	Director of Finance	City of Snyder
Southlake	Assistant Director of Finance	City of Southlake
Sugar Land	Financial Analyst	City of Sugar land
Sugar Land	Director of Finance & Administration	City of Sugar Land
Sugar Land	Accounting Manager	City of Sugar Land
Temple	Financial Analyst	City of Temple

Tomball	Director of Finance	City of Tomball
University Park	Director of Finance	City of University Park
Van Horn	City Admin/City Secretary	Town of Van Horn
Van Horn	Finance Director	City of Van Horn
Victoria	Director of Finance	City of Victoria
Waco	Partner	Pattillo, Brown & Hill LLP
Waco	Financial Supervisor	City of Waco
Watauga	Accounting Clerk I	City of Watauga
Watauga	Senior Accounting Clerk	City of Watauga
Weatherford	Staff Accountant	City of Weatherford
Weimar	Director of Finance	City of Weimar
White Settlement	Assistant Director of Finance	City of White Settlement
Wylie	Director Finance & Personnel	City of Wylie
Yoakum	Director of Finance	City of Yoakum