Standards Watch

What Is the Significance of GASB's Conceptual Framework?

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Traditionally, Concepts Statements garner much less attention from constituents of the Governmental Accounting Standards Board (GASB) than the Statements of governmental accounting standards that GASB has issued, but in my view they are no less important. I think of the conceptual framework as the foundation of fundamental premises (concepts) upon which sound and consistent accounting and financial reporting standards are built. The primary goal of GASB's conceptual framework—to date comprising five Concepts Statements—is to set the underlying philosophy and the boundaries for judgment that will guide GASB in resolving accounting and financial reporting issues brought before the board. The conceptual framework is intended to encompass reporting objectives, a set of definitions and broad principles intended to guide the board members as they deliberate how governments should account for and report on transactions and events. Concepts Statements assist the board in determining, for instance, if and when an asset or liability should be recorded as a result of a particular transaction, how it should be measured and where in the financial report it should be reported. Because GASB members' terms are limited, the concepts provide the board's regularly changing membership with a common foundation and basic reasoning against which to consider the merits of alternative accounting and reporting approaches.

The Benefits of Concepts Statements

Being able to refer readily to the conceptual framework is a great benefit to high-quality standards-setting. Standards also can be timelier when the board does not have to start from scratch as it considers each new project, because many fundamental topics have already been addressed in the conceptual framework. It does not have to rehash what constitutes an inflow or outflow of resources, for example, or whether a particular type of information is best reported in the notes to the financial statements or as required supplementary information. Timelier standards provide necessary guidance to governments to address new issues as they arise and result in needed information reaching financial statement users in time for them to incorporate it into their decision-making.

Consistent standards born of a solid conceptual framework also are more predictable. This is valuable for several reasons. Predictable standards ask governments to account for and report similar transactions and events in similar ways. Such standards do not take GASB's constituents by surprise because they are grounded in the same concepts as all of the other standards. Concepts Statements also give constituents a benchmark against which to judge proposed standards; that is, based on the degree to which the proposal conforms to the conceptual framework.

Concepts Statements also can be useful to the preparers and auditors of financial statements as guidance on issues for which no explicit standards exist. A government accountant dealing with a new or unique transaction may turn to the Concepts Statements for assistance in deciding how to report on it when GASB's standards do not prescribe a specific approach.

The Challenges of Concepts Statements

The notion that standards-setters like GASB should have a conceptual framework upon which to found their standards is a great idea—in concept. But for a variety of reasons, Concepts Statements can prove difficult to contend with.

Pragmatically, projects to develop Concepts Statements compete for the time and resources of the board with other projects relating to issues that GASB constituents are currently faced with. In the eyes of some, a project that resolves a pressing accounting issue is a higher priority than a conceptual framework project that will help the board, but whose broader benefits are not as readily apparent. And conceptual framework projects are not fast-track efforts, either.

The development of *Concepts Statement No. 3, Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, lasted three years from its addition to

GASB's current technical agenda to its publication, but in fact the board had worked on that part of the conceptual framework for years, prior to setting the project aside to complete Statement No. 34, *Basic Financial Statements—and Management's and Discussion and Analysis—for State and Local Governments*. Concepts Statement No. 4, *Elements of Financial Statements*, had a similarly long development period.

Conceptual framework projects are usually difficult. One might think that it is a simple matter to define an asset—it is something a government owns, right? Assuming you can reach consensus on the meaning of the word "own," such a definition would seem to exclude property associated with long-term leases, as well as fiduciary assets that a government is responsible for, because technically, they are owned by someone else. So perhaps what we mean is something a government controls; determining what constitutes control, as you might imagine, is a whole other can of worms. For the record, Concepts Statement 4 defines assets succinctly as "resources with present service capacity that the government presently controls" (but devotes nine additional paragraphs to clarify the definitions of "resources," "present service capacity" and "controls").

Because they deal with the most fundamental issues in accounting and financial reporting, Concepts Statements have potentially wide-ranging repercussions. It can be challenging to work on a conceptual level without being unduly influenced by how a particular definition could impact accounting and reporting under existing or future standards. How might current standards be changed when reexamined in the future, based upon these new concepts? As an example, GASB is currently in the process of reexamining its pension accounting standards to determine if they are effective or if any changes are needed to improve those standards. That reexamination is being done in light of a definition of liabilities in Concepts Statement 4 that didn't exist when the original pension standards were issued in the mid-1990s.

It is possible, too, that a strict adherence to the conceptual framework when addressing an issue through standards-setting could lead to unpopular accounting or reporting solutions. Deviating from a solution conforming with the conceptual framework is allowable, but it is considered incumbent upon the board to explain why it believes it is appropriate to diverge from its own concepts.

Components of GASB's Conceptual Framework

One of GASB's earliest projects led to the issuance in 1987 of Concepts Statement No. 1, *Objectives of Financial Reporting*. The Financial Accounting Standards Board had already issued Concepts Statements on the objectives of financial reporting by corporations and not-for-profit organizations, but GASB struck out on its own to describe the unique nature of governmental entities and the distinguishing characteristics of the environment they operate in. Concepts Statement 1 identified who uses governmental financial statements, the purposes for which they use them, and, by extension, the reasons why governments prepare and issue financial statements externally. Concepts Statement No. 2, *Service Efforts and Accomplishments Reporting*, expanded upon one of the objectives of financial reporting, giving fuller treatment to the importance of reporting service performance by entities, such as governments, that do not exist to generate a profit and need other metrics to assess performance. This Concepts Statement was subsequently amended by GASB's fifth Concepts Statement, to reflect what GASB had learned from 20 years of research on SEA reporting and monitoring of actual reporting by governments.

Concepts Statement 3 defines the basic methods of communicating information in a traditional financial report, and establishes a hierarchy for presenting information in the financial statements, notes to the financial statements and supporting information (required supplementary information and supplementary information). It sets the criteria the board uses to decide where a specific piece of information should be presented.

Concepts Statement 4 broke considerable new ground, forgoing the traditional approach of defining an asset in terms of its cash-generating ability and then defining the other elements in relation to assets. Instead of focusing solely on the ability to produce cash, GASB's definition of assets also considers service potential, because the purpose of governments is to provide services for the common good, rather than to earn profits. In addition, GASB developed definitions of the individual elements that are independent of each other as much as possible; it took a different path because it did not believe that any particular element should be seen as more important than another.

Because of the importance of being able to assess inter-period equity in the government environment (see my article in the Summer 2009 issue), the Concepts Statement also defines deferred inflows and deferred outflows of resources as separate elements. This has not been done by other standards-setters, leaving many to wonder just what deferrals are and why they appear with the assets and liabilities in a statement of financial position when they often do not bear the same characteristics of either. These deferrals might be looked at as future revenues and expenses waiting until certain future events have occurred or a particular point in time has been reached to be reported in the operating or financial flows statements.

The Conceptual Framework Going Forward

Having dealt with why governments report and to whom (Concepts Statement 1), what elements of financial statements should be reported (Concepts Statement 4) and where information should be reported (Concepts Statement 3), at present GASB is deliberating when information should be reported and how it should be measured. GASB's project on recognition and measurement attributes, like the projects that led to the concepts on communication methods and elements, has been the subject of lengthy deliberations and likely will continue for an extended period.

The board has reached tentative decisions on matters relating to measurement attributes, including that there should be two basic measurement attributes:

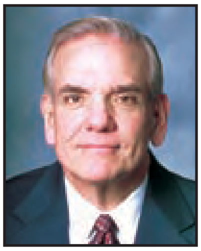
- Initial Transaction Date-Based Measurement (Initial Value)—the transaction price or value assigned when an asset was acquired or a liability was incurred, including subsequent modifications to that price or value, such as through amortization or depreciation.
- Current Financial Statement Date-Based Measurement (Remeasured value)—the value of an asset or liability remeasured as of the financial statement date, including fair value; current acquisition, sale and settlement price; replacement cost; and value-in-use.

The board has tentatively agreed, as it relates to financial statements that employ the economic resources measurement focus, that the most appropriate measurement attribute for assets used in the provision of services (such as capital assets) is initial values. Remeasured value is generally the best measurement attribute for assets not used in providing services (for example, receivables and investments). Regarding liabilities, initial value is generally the best measurement attribute for liabilities for which payment amounts and dates are specified (such as vendor payments), whereas remeasured value is the best measurement attribute for liabilities for which payment amounts and dates are unknown (for instance, compensated absences or other postemployment benefit obligations).

In certain cases, matters of recognition and measurement have proven to be particularly thorny, such as with respect to identifying the unique informational value of the current financial resources (as opposed to economic resources and cash) measurement focus that is used in governmental fund reporting. GASB staff has conducted extensive interviews with financial statement users and others regarding this measurement focus. GASB expects to issue a Preliminary Views document for public comment by the end of 2010. More information about the project can be found at *www.gasb.org/project_pages/*.

Final Thoughts

As important as I believe the Concepts Statement are, I would be remiss if I didn't point out the fact that Concepts Statements are not considered "authoritative" in the hierarchy of generally accepted accounting principles (GAAP). In the current hierarchy, Concepts Statements are treated as other accounting literature, ranking them below the four levels of authoritative GAAP. The reason for that treatment in the hierarchy was the belief that the Concepts Statements were primarily for the use and guidance of the board in setting standards, not for implementation by preparers of government financial statements. This means that when GASB issues new or amended Concepts Statements, they do not have a direct impact on current accounting and financial reporting or current practice by superseding existing pronouncements. However, they very well may have an impact in the future as new standards are issued and existing standards are reexamined through the normal course of standards-setting.



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