



Testimony of
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Before the

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Capital Markets and Government Sponsored Enterprises

Accounting and Auditing Oversight: Pending Proposals and Emerging Issues
Confronting Regulators, Standard Setters and the Economy

March 28, 2012

Chairman Garrett, Ranking Minority Member Waters, and Members of the Subcommittee, thank you for this opportunity to participate in today's hearing. My name is Robert Attmore. I am the Chairman of the Governmental Accounting Standards Board (GASB) and have served in that capacity since 2004. Before joining the GASB, I was a Deputy Comptroller for the State of New York and served as the N.Y. State Auditor. Before joining the State in 1979, I worked for Deloitte, a major public accounting firm.

Because this the first time in the 27-year history of the GASB that we have appeared before Congress, I would like to briefly provide some background on our organization. The GASB was set up as an independent private-sector organization that establishes accounting and financial reporting standards for state and local governments in the United States. The GASB operates under the auspices of the Financial Accounting Foundation (FAF) which has oversight authority for both the GASB and the Financial Accounting Standards Board (FASB).

Individual sovereign state governments have the authority to establish accounting and financial reporting standards for themselves and their local jurisdictions. Before the GASB was created, state and local government accounting and financial reporting standards were established for over 50 years by the National Council on Governmental Accounting (NCGA) and its predecessors. In the wake of a financial crisis in the 1970s, state governments recognized a need for change. In order to adequately meet the needs of financial report users in the municipal bond market, state representatives determined they needed an independent, national, standards-setting body for state and local governments comparable to the FASB. State organizations, working with the FAF, the American Institute of Certified Public Accountants, local government organizations, and the Government Accountability Office, reached an agreement in 1984 to create the GASB, which began operations that year. Today, all state governments follow GASB standards.

The GASB is recognized by state and local governments, resource providers, the accounting industry, and the capital markets as the official source of generally accepted accounting principles (GAAP) for state

and local governments. Tribal governments in the United States and United States territories also have chosen to follow the GASB pronouncements. While recognized as an authoritative standard setter, the GASB does not have enforcement authority. Compliance with GASB's standards, however, is enforced through the laws of many individual states and through the audit process, when auditors render opinions on the fairness of financial statement presentations in conformity with GAAP.

GASB's Mission and Guiding Principles

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.

The mission is accomplished through a comprehensive and independent process that encourages broad participation, objectively considers all stakeholder views, and is subject to oversight by the FAF's Board of Trustees.

GASB publications note that external financial reporting assists in fulfilling government's duty to be publicly accountable and that such reporting is used to assess accountability and to make economic, social, and political decisions. Those publications also identify the primary users of state and local government financial reports as those:

- To whom government is primarily accountable—its citizens
- Who directly represent the citizens—legislative and oversight bodies
- Who finance government or who participate in the financing process—taxpayers, other governments, investors, creditors, underwriters, and analysts.

Sometimes government administrators also are users of financial reports; whether they are considered primary users depends on whether they have ready access to internal financial information.

To accomplish its mission, the GASB acts to:

- Issue high-quality standards that improve the usefulness of financial reports based on the needs of financial report users and on the underlying concepts set out in the GASB's conceptual framework
- Keep standards current to reflect changes in the governmental environment
- Provide guidance on implementation of standards
- Consider significant areas of accounting and financial reporting that can be improved through the standards-setting process
- Improve the common understanding of the nature and purposes of information contained in financial reports.

The GASB develops and uses concepts to guide its work of establishing standards. Those concepts provide a frame of reference, or conceptual framework, for resolving accounting and financial reporting issues.

The GASB's work on both standards and other communications, including concepts, is based on research conducted by the GASB's technical staff and others. The GASB actively solicits and considers the views of its various stakeholders on all accounting and financial reporting issues. The GASB's activities are open to public participation and observation under the "due process" procedures mandated by its Rules of Procedure.

In establishing standards and concepts, the GASB exercises its judgment after research, public due process, and careful deliberation. It is guided by these principles:

- To be objective and neutral in its decision making and to ensure, as much as possible, that the information resulting from its standards is a faithful representation of the effects of state and local government activities. Objective and neutral mean freedom from bias, precluding the GASB from placing any particular interest above the interests of the many who rely on the information contained in financial reports.
- To weigh carefully the views of its stakeholders in developing standards and concepts so that they will:

- a. Meet the decision-making needs of the users of government financial reports, and
 - b. Gain general acceptance among state and local government preparers and auditors of financial reports.
- To establish standards only when the expected benefits to be derived exceed the perceived costs. The GASB strives to determine that proposed standards (including disclosure requirements) fill a significant need and that the costs they impose, compared with possible alternatives, are justified when compared to the overall public benefit.
 - To consider the applicability of its standards to the separately issued general purpose financial statements of governmentally owned special entities. The GASB is aware of the unique and distinguishing characteristics of the government environment, which may require different standards from those used by similar private-sector entities. However, it specifically evaluates similarities of special entities and of their activities and transactions in both the public and private sectors, and the need, in certain instances, for comparability with the private sector.
 - To bring about needed changes in ways that balance the desire to minimize disruption of accounting and financial reporting processes with the need for information in financial reports to communicate effectively to users. The GASB establishes reasonable effective dates and transition provisions when new standards are introduced.
 - To review the effects of past decisions and interpret, amend, or replace standards when appropriate.

The GASB also works to educate the public, including financial statement preparers, auditors, and users, about its standards and the information those standards require governments to present in their financial reports. In order to encourage broad public participation in the standards-setting process, GASB standards and other communications are issued only after completion of extensive and rigorous public due process.

Board Members and Staff

The GASB standards and other communications are established by a seven-member Board whose members are selected by the Trustees of the FAF. The Chairman serves on a full-time basis with the remaining six members devoting approximately one-third of their time to GASB

activities. The Board holds face-to-face public meetings every six weeks. Those meetings generally are held over a three day period. Due to the part-time nature of the Board, the face-to-face meetings are supplemented by half-day public teleconference meetings that are generally the third week after the face-to-face meeting.

In addition to me, the current Board membership is as follows:

William W. Fish (term expires 2016) joined the GASB on February 1, 2012.

Michael H. Granof (term expires 2015) began serving as a member of the GASB on July 1, 2010.

David E. Sundstrom (term expires 2014) began serving as a member of the GASB on July 1, 2009.

Jan I. Sylvis (term expires 2017) began serving as a member of the GASB on July 1, 2007.

Marcia L. Taylor (term expires 2015) joined the GASB on July 1, 2005.

James M. Williams (term expires 2012) joined the GASB on July 1, 2002.

The Board members are supported by 17 technical and 4 administrative staff. The technical staff is drawn from the preparer, audit, and user communities from around the United States. As discussed below, the staff conducts basic research, and prepares papers and proposals that set forth issues to be deliberated by the Board members in public meetings.

Why Different Standards for State and Local Governments?

Accounting and financial reporting standards designed for the government environment are essential because governments are fundamentally different from for-profit businesses in several important ways. Their purpose is different, in that governments provide public services rather than seek to generate wealth for business owners, and the way they are financed is very different. For example, businesses receive revenues from a voluntary exchange of perceived equal values between a willing buyer and seller; whereas, governments obtain resources primarily from the required payment of taxes, and the specific taxes paid by an individual taxpayer often bear little

direct relationship to the value of services received by that taxpayer. Furthermore, the information needs of the variety of users of government financial statements are different from the needs of the users of nongovernmental financial statements. For example, governmental accounting and financial reporting standards aim to address the need for information to help stakeholders assess how public resources are acquired and used, whether current resources were sufficient to meet current service costs or whether some costs were shifted to future taxpayers, and whether the government's financial position and its ability to provide services improved or deteriorated from the previous year.

GASB Due Process

The GASB's due process activities are described in its published Rules of Procedure. The GASB's stringent due process activities are designed to encourage broad public participation in the standards setting process. These activities promote timely, thorough, and open study of financial accounting and reporting issues by the preparers, auditors, and users of financial reports. For many of the issues it addresses, the GASB:

- Appoints an advisory task force of outside experts
- Studies existing literature on the subject (including pronouncements previously issued by the Federal Accounting Standards Advisory Board (FASAB), FASB, and the International Public Sector Accounting Standards Board and conducts or commissions additional research if necessary
- Publishes a discussion document for public comment setting forth the issues or concerns being addressed and possible solutions
- Broadly distributes an Exposure Draft of a proposed standard for public comment
- Conducts public hearings and user forums on its due process documents.

Significant steps in the process are announced publicly. The GASB's meetings are open for public observation and a public record is maintained. The GASB also is advised by the

Governmental Accounting Standards Advisory Council (GASAC), a 30-member group appointed by the FAF Trustees that represents a wide range of the GASB's stakeholders.

Transcripts of public hearings, letters of comment and position papers, research reports and other relevant materials on projects leading to issuance of pronouncements become part of the Board's public record and are available for inspection. To encourage public comment, discussion documents and Exposure Drafts are made available for download on the Internet. Single printed copies also are available without charge during the comment period to all who request them. Final pronouncements are distributed when published through GASB subscription plans or may be purchased separately.

GASB Funding

The Sarbanes-Oxley Act of 2002 provided an independent, stable source of funding for the FASB. An adequately funded independent private-sector standard setter also is essential for the state and local government environment and the municipal securities market. Although states essentially delegated their authority for prescribing accounting and financial reporting standards for state and local governments to the GASB (under the oversight of the FAF) in 1984, the GASB has been funded in a piecemeal, inadequate manner by voluntary contributions from states, local governments, the financial community, and through sales of FAF publications since its inception.

The recent financial and economic crisis has demonstrated the urgency to ensure full disclosure and transparency in the municipal securities market. The municipal securities market is a key component of our nation's capital markets. The Federal Reserve Board has estimated the size of the municipal securities market at \$3.7 trillion with over 50,000 issuers as of September 30, 2011. GASB has an essential role in this market by issuing high-quality, independently established governmental accounting standards that provide a foundation for financial reporting that investors can rely on to make informed investment decisions.

The municipal securities market is largely a retail market. According to a June 2011 Federal Reserve Board statistical release, approximately 51% of the \$3.7 trillion municipal securities market is held by individual investors and an additional 22% is held by mutual funds. As such, these securities are not only critical to financing infrastructure and other government needs, they are important to American investors seeking safe state and local government investments.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (WSRA) became law. §978(a) of the WSRA empowers the U.S. Securities and Exchange Commission (Commission) to require a national securities association to establish a reasonable annual accounting support fee adequate to fund the annual budget of the GASB to ensure high-quality state and local governmental accounting and financial reporting standards. As a result, the Commission directed the Financial Industry Regulatory Authority, Inc. (FINRA) to establish a reasonable accounting support fee and related rules and procedures to provide a sustainable funding mechanism to support the efforts of the GASB. On February 23, 2012, the Commission issued an order granting approval of FINRA's proposed rule change establishing a GASB Accounting Support fee.

Securing an independent funding source for the GASB is a tremendous milestone in the Board's history and represents the far-reaching recognition by the municipal capital markets of the importance of transparent financial information and the important role that GASB plays in fostering high-quality financial accounting and reporting. I am grateful to Congress for recognizing the need for this secure and independent funding source for the GASB.

Current GASB Activities

Accounting and financial reporting is in a state of continual improvement. At any one time, the GASB has four to six major projects on its current technical agenda and two to four more limited

scope projects that focus on practice issues. In addition, there are usually four to six projects where initial research is being conducted by the staff. During the past year, the GASB has focused its efforts on four major projects:

- Postemployment Benefits—pension accounting and financial reporting and reporting of other postemployment benefits, including retiree healthcare
- Economic condition reporting: financial projections
- Financial guarantees
- Government combinations

The following is a summary of activities to date associated with these four projects and major issues identified by the GASB in each of those projects.

Postemployment Benefits Project

Pension Accounting and Financial Reporting

The Board currently is considering improvements to existing standards of accounting and financial reporting for pension benefits by state and local governmental employers and by the trustees, administrators, or sponsors of pension plans. One objective of this project is to improve the transparency of financial reporting, in regard to the financial effects of employers' commitments and actions related to pension benefits. This objective would include improving the information provided to help financial report users assess the degree to which *interperiod equity* has been achieved. Another objective of this project is to improve the *usefulness* of information for decisions or judgments of relevance to the various users of the general-purpose external financial reports of governmental employers and pension plans.

This project follows a research project initiated by the Board in January 2006 to gather information regarding how effective the standards established for pension accounting and financial reporting—Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans*

and Note Disclosures for Defined Contribution Plans, and Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*—have been in providing decision-useful information. The research project was conducted, in part, as a result of the Board’s commitment to periodically reexamine its standards. The research project provided an opportunity to review how state and local governments and pension plans applied the requirements of Statements 25 and 27 and how financial reporting reflected the transactions and events affecting pensions from the issuance of those standards in 1996. In 2008, the Board concluded that, based on the results of this research, additional improvements should be considered. The Board has drawn upon the work of various standards setters for the pension project, including the FASB and FASAB.

Since the project was added to the current technical agenda, the Board has issued the following due process documents to solicit constituent feedback:

- Invitation to Comment, *Pension Accounting and Financial Reporting*—which was issued in March 2009
- Preliminary Views, *Pension Accounting and Financial Reporting by Employers*-which was issued in June 2010
- Exposure Drafts, *Accounting and Financial Reporting for Pensions and Financial Reporting for Pension Plans*—which were issue in June 2011

The Board held multiple public hearings for each of the documents as part of its extensive due process. In addition, the Board conducted a field test with financial statement preparers in late 2011 to assist the Board in identifying the costs associated with the pension proposals and potential implementation issues. The Board also held three financial statement user forums in October 2011 to further identify and understand the perspectives of financial statement users regarding the anticipated benefits from the pension proposals.

The Board is currently in the process of again deliberating its tentative decisions based on the feedback to the proposals that were included in the employer Exposure Draft. The GASB proposed that generally a government (the employer) that provides pension benefits to its employees is responsible for the net pension liability and would report it in its financial statements.

A total pension liability is measured based on actuarially-calculated methods using assumptions that are consistent with the American Academy of Actuaries' Actuarial Standards of Practice, unless otherwise specified by the GASB. The total pension liability less amounts held in a qualifying pension trust, which generally are measured at fair value, equals the net pension liability. The measurement of the total pension liability is based on projecting future benefits payments, discounting those benefits to a present value, and attributing the present value of the projected benefits to appropriate service periods (past, present, and future).

Based on the career-long employer/employee relationship that is being measured, the GASB has proposed to continue the current practice of incorporating expectations of future employment-related events and cost-of-living increases into the projections of benefit payments.

As long as plan assets related to current employees, retirees, and their beneficiaries are projected to be sufficient to make the projected benefit payments for those individuals, governments would discount projected benefit payments using a long-term expected rate of return on plan investments. For some governments, however, there will be a point at which the plan assets are no longer projected to be available to be invested long term and, therefore, would not be sufficient for paying benefits to current employees, retirees, and their beneficiaries. The GASB believes that from point forward, the projected benefit payments take on attributes that are similar to other forms of debt. In this circumstance, governments would incorporate into the calculation of the discount rate a tax-exempt, high-quality municipal bond index rate to reflect that future benefit payments are not expected to be made from earnings on long-term investments.

The GASB also has proposed that all governments use a single actuarial cost method for attributing the present value of projected benefits to past, present, and future periods that is known as entry age, and to apply that method as a level percentage of payroll.

The effects of changes in the net pension liability resulting from service cost, interest cost, benefit changes, and projected earnings on plan investments should be recognized in pension expense in the period of the change. Changes in the net pension liability due to differences between expected and actual experience with regard to economic or demographic factors, and the effects of changes of assumptions about future economic and demographic factors for all employees and retirees, should be recognized in pension expense over the average expected remaining service lives of all employees and retirees using a systematic and rational, closed-period method. Differences between projected and actual plan investment earnings should be recognized in pension expense over a closed five-year period, in a systematic and rational manner.

The Board is expected to complete its deliberations on the proposed pension standards in the summer. New pension Statements would then be issued assuming that no significant changes are made to the prior proposals (which would result in the reexposure of new proposals).

Other Postemployment Benefits

In addition to the pension accounting and financial reporting project, the Board also has a companion project that addresses other postemployment benefits (OPEB), including retiree healthcare benefits. Since the issuance of the OPEB recognition standards in 2004, state and local governments, for the first time, have been required to disclose the extent of their retiree healthcare obligations in the notes to their financial statements. This new project will reexamine the measurement and recognition provisions related to those OPEB obligations. Deliberations on this project are scheduled to restart in July 2012.

Economic Condition Reporting: Financial Projections

The objective of this project is to consider what guidance, if any, should be provided for additional information about a government's economic condition. The project examines the usefulness of indicators of economic condition and its related components. This project also includes consideration of the information financial statement users identified as necessary to assess the risks associated with a government's intergovernmental financial dependencies.

The GASB's research indicates that users of financial reports are interested in understanding a governmental entity's *past* economic condition—and thus how the governmental entity arrived at its current status—with an eye toward assessing a governmental entity's *future* financial viability or fiscal sustainability. In other words, based on existing information, users seek to assess a governmental entity's *ongoing* ability to raise revenue, to deliver services, to issue debt, and to meet its obligations and commitments as they become due—the capacity to *sustain* or improve its financial status. Fiscal sustainability is the forward-looking aspect of economic condition. The GASB has tentatively defined fiscal sustainability as a government's ability and willingness to generate inflows of resources necessary to honor current service commitments and to meet financial obligations as they come due, without transferring financial obligations to future periods that do not result in commensurate benefits.

The current technical agenda project was begun in 2010 and in October 2011, the Board issued its Preliminary Views, *Economic Condition Reporting: Financial Projections*. The Preliminary Views presents the Board's current tentative views on what it believes are the most fundamental issues associated with the reporting of financial projections and related narrative discussions that will assist users in assessing a governmental entity's economic condition. The Board's intent is to obtain comments from constituents before developing more detailed proposals for potential new standards.

The Board's preliminary view is that projections of the following information for each of the next five years are necessary to assist users in assessing a governmental entity's fiscal sustainability:

- Cash inflows and cash outflows, with explanations of the known causes of fluctuations in cash inflows or cash outflows
- Financial obligations, including bonds, pensions, other postemployment benefits, and long-term contracts, with explanations of the known causes of fluctuations
- Annual debt service payments (principal and interest)

A narrative discussion of a government's major dependencies on other governments to provide its services also would be included.

Similar to guidance that is currently effective for the federal government based on standards established by the FASAB, financial projections would be (1) based on current policy, (2) informed by historical information, and (3) adjusted for known events and conditions that affect the projection periods. Assumptions employed in making projections would be (1) consistent with each other and with the information used as the basis for the assumptions and (2) comprehensive by considering significant trends, events, and conditions. Disclosure of key assumptions would be required.

It is important to note that projections based on current policy do not represent a forecast or a prediction of the most likely outcome. Financial projections may be based upon assumptions regarding changes in social, economic, and demographic events and conditions that are inherently subject to uncertainties. Therefore, a cautionary notice would precede the displayed financial projections and related narrative discussions advising readers that actual results may vary from the financial projections reported.

The Board plans to hold public hearings on these preliminary views in late March and April before again beginning deliberations based on constituent feedback later this spring.

Financial Guarantees

The objective of the financial guarantees project is to establish additional guidance regarding the recognition and disclosure of financial guarantees made and received by state and local governments.

The GASB staff's research indicates that financial guarantees are primarily associated with commitments related to debt issued by other governmental units, not-for-profits, and in certain cases for-profit organizations. The guarantees, however, may take other forms, including statutory commitments. The current economic environment has resulted in a level of financial

stress that has touched most organizations, resulting in financial guarantees that have been made or received in the past that are now coming to light. Currently, generic and specific accounting and financial reporting guidance for these transactions derives from multiple sources, to the extent it exists. There is no single, comprehensive source of guidance for these guarantee transactions. Due to the heightened importance of these guarantees and the potential for them to result in claims, the Board believes that it is important to establish clear recognition and disclosure requirements.

Since the project was added to the current technical agenda in April 2011 the Board has reached several tentative conclusions that it plans to expose for public comment later this year. These tentative conclusions include proposals related to measurement and recognition standards.

For guarantees extended for which qualitative factors indicate that it is more likely than not an indemnification payment will be made, the amount of the liability should be measured using a cost accumulation approach. An Exposure Draft is scheduled to be issued in June 2012 for public comment.

Government Combinations and Disposals of Government Operations

The primary objective of the current government combinations project is to consider the financial reporting requirements for government combinations that are accomplished through annexation, consolidation, acquisition, shared service arrangements, or by other means. This project includes the analysis of government combinations that have taken place in both the general governmental area (for example, city/county consolidations and consolidated school districts) and the business-type activities area (for example, healthcare organizations). In addition, the project addresses certain devolution (spin-off) issues; for example, accounting for a library district that was formerly a department in a primary government.

Until now, governments have accounted for mergers, acquisitions, and other combinations by analogizing to accounting and financial reporting guidance intended for the business environment, generally APB Opinion No. 16, *Business Combinations*. This proposed Statement would provide accounting and financial reporting guidance for combinations that would be specifically relevant to the governmental environment. This proposed Statement also would

improve the decision usefulness of financial reporting by requiring that relevant disclosures be made by governments about combination arrangements in which they engage and for disposals of government operations.

The project was added to the current technical agenda in December 2010. Since that date, the Board has reached tentative conclusions that were exposed for public comment earlier this month. These tentative conclusions include:

- Government combinations are identified by whether governments and other entities or their operations are transferred to (a merger or transfer of government operations) or purchased (an acquisition) by a government and the services associated with an entity or operation will continue after a government combination has occurred.
- Carrying values would be used to measure the assets and liabilities in a government merger or transfer of government operations. Measurements of assets acquired and liabilities assumed in an acquisition generally are to be based upon their acquisition values.

Other Projects

In addition to these four major projects that were addressed herein, the Board has other projects on its current technical agenda and projects on its research agenda. A list of all GASB projects, along with a projected due process timetable is presented in Attachment A. Additional information on all GASB projects can be found at the GASB's website, www.gasb.org.

Conclusion

In conclusion, the GASB has made significant progress over the past 27 years, but there is still much left to do. With continued oversight by the FAF, a robust public due process that encourages and values broad participation from all GASB constituents, and dedicated Board members and staff, the GASB is up to the challenges that lie ahead.

Thank you again Mr. Chairman for the opportunity to appear before the Subcommittee.

Attachment A

GASB Current Technical Agenda: Overview (As of 3/15/12)

Project	Issued		To Be Issued		
	ITC/PV	ED	DPD/PV	ED	Final
Major Projects:					
Conceptual Framework— Recognition and Measurement Approaches	6/11	—	—	4Q12	2Q13
Economic Condition Reporting: Financial Projections	11/11	—	—	4Q12	3Q13
Fair Value Measurement and Application	—	—	—	1Q13	4Q13
Financial Guarantees	—	—	—	2Q12	1Q13
Government Combinations	—	3/12	—	—	4Q12
Postemployment Benefit Accounting and Financial Reporting—					
Other Postemployment Benefit Accounting and Financial Reporting	—	—	—	3Q13	2Q14
Pension Accounting and Financial Reporting	3/09 6/10	6/11	—	—	2Q12

GASB Current Technical Agenda: Overview (As of 3/15/12)

Project	Issued		To Be Issued		
	ITC/PV	ED	ITC/PV	ED	Final
Practice Issues:					
Comprehensive Implementation Guide—					
Annual Update	—	—	—	—	3Q12
Mid-Year Supplement	—	—	—	—	1Q13
User Guides—Update	—	—	—	—	2Q12

ED—Exposure Draft
 Final—Statement, unless otherwise noted
 ITC—Invitation to Comment

PV—Preliminary Views
 RED—Revised Exposure Draft
 RFR—Request for Response
 TB—Technical Bulletin

Research Projects

Electronic Financial Reporting
Fiduciary Responsibility
GAAP Hierarchy
Leases