The Effectiveness of Setting Governmental Accounting Standards

The Case of Michigan Governments in Fiscal Distress

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Abstract

The purpose of setting accounting standards is to improve the quality of the financial statements on which users base their decisions. The financial reporting model set up by the Governmental Accounting Standards Board (GASB) is comprehensive and complex, as are the governments on which these statements report. We provide a framework for evaluating whether financial statements are used and understood by decision makers and explain the components of the GASB Statement No. 34 financial reporting model introduced in 1999. We present financial indicators from the Comprehensive Annual Financial Reports for 12 Michigan governments over three points in a 10-year period, along with an indication of whether trends are favorable or unfavorable. We suggest that governing bodies assess to what extent their members use financial statements in making decisions. If officials are trained to monitor financial performance on a regular basis, then decision-making may improve and fiscal crises may be averted.

JEL codes: M41, M42, M48

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The Effectiveness of Setting Governmental Accounting Standards

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The purpose of setting accounting standards for any type of business or nonbusiness entity is to ensure that users of financial information have quality information in order to make informed decisions. The set of financial reports, comprising an income statement, a statement of owners' equity, a balance sheet, and a statement of cash flows audited by an independent certified public accountant (CPA), has served the needs of the for-profit/investor-owned sector of the US economy well for more than 70 years. Naturally, the generally accepted accounting principles (GAAP) on which these statements are based have evolved over time. Howard Greer recognized the importance of accounting evolving to serve broad-based public decision making. In his 1962 foreword to a reprinting of W. A. Paton and A. C. Littleton's 1940 seminal book on accounting standards, he says,

> Where the accountant once was concerned merely with assisting the owners of a business to evaluate its operations in money terms, he now must recognize a broad social responsibility. His findings, and the manner in which he sets them forth, have become the basis for significant decisions and policies, not only in business affairs, but in economic, social, and political matters as well. (Paton and Littleton 1962, v)

A very broad set of stakeholders make important decisions related to public entities. Businesses consider tax burdens when deciding in which state or city to locate. Taxpayers elect board members to govern the use of public resources. Parents "vote with their feet" when choosing a school district in which to live. Other government stakeholders include voters, residents, governing bodies, employee unions, vendors, and bondholders. Although nonfinancial factors are also important in the decisions these stakeholders make, it is the financial statements that capture the effect of economic transactions in which entities engage over time. States require local governments[1] to produce financial statements and make these accessible to the public so they are useful in making informed decisions. Financial statements tell the story of both the short-term financial position and longer-term economic condition of entities.

The process of setting accounting standards is an art, not a science; it follows a systematic due process in which stakeholders have an opportunity to provide input throughout—from identifying accounting issues to be researched to the adoption of a standard to be followed as "generally accepted." Tom Allen, former chair of the Governmental Accounting Standards Board (GASB), says the standards-setting process is complicated, not only because of the complex nature of governments, but also because so few citizens know how to read financial statements and actually take the time to do so (Allen 2008). Practically, decision makers rely on intermediaries, such as the media and bond raters, to process and summarize information that comes from the financial reporting supply chain.

In section 1 we describe the characteristics of each of the sectors of the US economy that lead to different GAAP standards. In section 2 we explain the process of setting governmental accounting standards in the context of setting accounting standards for all organizations in the United States and globally. We present the GASB Statement No. 34 financial reporting model in section 3 with emphasis on the pair of accrual-based government-wide statements that complement the traditional fund accounting set of financial statements. In section 4, we examine trends in financial indicators from GAAP financial statements for 12 Michigan governments in fiscal distress. Finally, we present some recommendations in section 5 that are designed to increase the effectiveness of GAAP financial statements by increasing their use by governing body members so that fewer local governments find themselves in fiscal distress. The

[1] The terms "local government" and "government" are used in this paper to include both governments (such as counties, cities, and townships) and governmental units (such as public schools and utilities).

governmental accounting environment is abundant with abbreviations, so we provide a complete list of those we use at the end of this paper.

1. Complexity of the Governmental/Public Sector

The US economy is composed of entities that have different legal structures, missions, sources of revenue, and stakeholders holding them accountable for performance. Each entity has been allowed to operate independently of its incorporators by some authoritative body. For example, a state grants a business the right to incorporate in the commercial sector; the federal government grants tax-exempt status to not-for-profit organizations that have been incorporated under a state's nonprofit corporation statutes, and states are the authoritative body for establishing local governments as bodies "corporate and politic." Classifying entities into a business sector, a not-for-profit sector, or a governmental sector based on that authority and on each sector's distinguishing characteristics helps establish accountability systems.

The commercial or business sector, displayed in the left column of table 1, lists entities ranging from very informal single-owner businesses to more complex partnerships, companies, and corporations. The distinction among each of these types of business entities is based on the degree of control and the liability that owners face for debts of the business, the life of the business, and the tax treatment of business income. The common factor across each of these businesses is that there are owners who expect a return on their investment, either in the form of dividends distributed from retained earnings or in capital gains to be earned on sales of appreciated stock.

Table 1. Types of Entities in the Three Sectors of the US Economy

Commercial/business sector	Not-for-profit sector	Governmental/public sector
Sole proprietorship	**Independent sector: IRC Sec. 501c(3) (comprised of public charities and private foundations):**	Federal government
Partnerships	Private pre K–12 schools	Federal agencies and instrumentalities
Limited liability partnerships (LLP)	Private colleges and universities	Federally chartered corporations
Limited liability companies (LLC)	Not-for-profit health care organizations	States
Low-profit, limited liability companies (L3C)	Voluntary health and welfare organizations	**Local general-purpose governments:**
C-corporations (both privately held and publicly traded)	Scientific organizations	Counties
Professional corporations (PC)	Community foundations	Municipalities (e.g., cities, villages, townships, authorities, parishes, boroughs)
S corporations	Parent-teacher associations	**Local special-purpose governments:**
	Independent sector: IRC Sec. 501c(4):	Authorities, public utilities, commissions, toll roads, and bridges
	Social welfare organizations	Public and charter schools and districts
	Civic leagues	Public colleges and universities
	Health maintenance organizations	Public hospitals and healthcare organizations
	Advocacy organizations	Governmental not-for-profits
	Mutual benefit not-for-profits:	
	Labor unions, IRC Sec. 501c(5)	
	Business leagues and chambers, IRC Sec. 501c(6)	
	Social and recreational clubs, IRC Sec. 501c(7)	
	Other not-for-profit organizations:	
	Cemetery associations, IRC Sec. 501c(13)	
	Credit unions, IRC Sec. 501c(14)	
	Political action committees (Sec. 527)	

The not-for-profit organizations (NPOs) in the center column of table 1 are legal entities established by people who share a vision and mission but have no ownership rights in the organization, have no profit motive, and do not expect any return on their investment of time, energy, and money in the organization. Generally private revenue supports these organizations, not direct tax revenue; however many NPOs receive pass-through grants from federal, state, and local governments originating from tax revenues. Most of these organizations engage in nonexchange transactions with donors in the form of contributions where there is not an equal exchange of dollars for the benefits received. For example, a donor does not receive any value in exchange for a gift, except perhaps the intrinsic satisfaction from furthering the mission of the NPO or from being recognized as a philanthropic patron. The NPO[2] sector is complex. NPOs provide services in so many industries that there is a National Taxonomy of Exempt Entities with 26 core classification codes and hundreds more subcategories under those codes to differentiate among nonprofits by their primary mission.[3]

The governmental sector (shown in the far right column of table 1) includes entities that are vastly different in size and scope of public services—from the federal government and its agencies to states, local governments, public school systems, public utilities, public hospitals, and public universities. These are the characteristics that distinguish governments from not-for-profit organizations:

- Power rests in the hands of the people.
- People delegate power by electing public officials.

[2] Abbreviations used in this sector include NFP (not-for-profit), preferred by the American Institute of Certified Public Accountants; NGO (nongovernmental organization), used internationally; and NPO (nonprofit organization), used in many state statutes. In this paper, we use NPO.
[3] The National Taxonomy of Exempt Entities (NTEE) was created in the 1980s by the National Center for Charitable Statistics, part of the Urban Institute (www.urban.org/nonprofits/index.cfm). The NTEE is used by Guidestar, Inc., an Internet-based NPO that provides an extensive database of Form 990 tax returns and information for donors and NPOs (www.guidestar.org).

- Governments have the power to tax their citizens.

Classification schemes and acronyms may confuse a novice reader of financial reports but they are critical for accountants, auditors, and others in the financial reporting supply chain. The sector of the economy in which an entity is classified determines the authoritative standards setter and the generally accepted accounting principles that those bodies have put into place to best meet financial statement users' needs. Often the accountant must methodically untangle public and private joint ventures, strategic alliances by companies signaling their commitment to corporate social responsibility (Kopka et al. 2014), and relatively new entities like limited liability companies (L3Cs)[4] in order to focus on one reporting entity at a time.

The term "public" is used in all three sectors; however, it is problematic. Some businesses in the commercial sector issue stock that is *publicly* traded on stock exchanges; *public* charities in the not-for-profit sector are broadly supported by donations and grants from many people and organizations; and *public* schools in the governmental sector receive tax revenues from people. Two terms are used to avoid the confusion that may be caused with *public*: nonbusiness and nongovernmental.

Nonbusiness is a term used to group not-for-profit and governmental entities in contrast to businesses. Nonbusiness entities have no owners, have no profit motive, and engage in nonexchange transactions in which the person who provides resources does not receive an equal amount of consideration in exchange (i.e., donors making gifts to NPOs or citizens paying taxes to governments). A challenge for accountants is that a nonbusiness reports to a more diverse set of decision makers for a wider set of performance measures than does a business. Annual net

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[4] L3Cs are low-profit, limited liability companies that have been allowed in about eight states since 2008. L3C business owners who have a social entrepreneurial mission are allowed to receive program-related investments from private foundations. Proposed federal legislation would require the Internal Revenue Service to simplify the process for approving such transfers (H.R. 2832 Philanthropic Facilitation Act introduced July 25, 2013).

income might be a sufficient single measure of performance for a stockholder, but nonbusiness stakeholders come from many different perspectives and expect entities exempt from federal income taxes to be accountable for the public good.

Nongovernmental is a term used to group businesses and not-for-profit organizations in contrast to governments. The inherent differences between governments and businesses or NPOs go beyond the government's ability to generate revenue through its authority to tax. Government stakeholders make a range of political, social, and economic decisions about their states, local governments, and other public services as shown in the far right column of table 1 (Governmental Accounting Standards Board 2013). Governments do not operate in a competitive environment as do businesses, but governments do operate in an environment of publicly available information. Governments provide public goods, such as public safety and public utilities, which are difficult for individuals to attain on their own. Governments invest in long-term capital assets to provide services to their current and future citizens, so it is important that they be accountable for the long-term debt burden that is incurred to acquire such capital assets. Historically, public employee unions representing teachers, police, fire, and other municipal employee groups have often negotiated with governments for long-term contracts for current and retirement benefits. One of the widely accepted views about why a government differs from a private-sector entity relates to the role of the budget as an annual exercise in establishing priorities for spending on public services and authorization for acquiring resources. The budget process includes input from citizens in public forums, approval by duly elected governing bodies, and legislative sanctions for government managers who spend more than what was legally authorized. In their study of accounting practices in the public sector, Stalebrink and Sacco point to the historic importance of budgeting in governments:

> Historically, the task of financial accounting and reporting in government has been regarded as best fulfilled by the use of an accounting and reporting model that is focused on constraining the behavior of public agents to behave in accordance with budgetary mandate sanctioned by the legislative process. (2003, 340).

This study explores whether governments are so different that they need a separate financial reporting model or whether commercial accounting practices would better professionalize governments. The rationales increasingly used by governments worldwide for adopting accrual-based business accounting practices include (1) democratic accountability: stakeholders need to know the full cost of governmental services and the total debt incurred to provide these services; (2) better management: internal managers can better measure performance leading to efficiencies; and (3) global capital markets: bondholders can assess whether the "full faith and credit" of the government is sufficient to cover debt obligations without burdening future generations.[5]

Although federal and state governments in some way oversee all entities operating in the United States, the federal government generally limits its "regulation" of financial information to businesses whose stock is publicly traded, some statutory accounting practices for utilities, and, more recently, some auditing practices. Most of the standards-setting activities for accounting remain in the private sector and take the form of GAAP rather than regulations.

2. Setting Accounting Standards

The American Institute of Certified Public Accountants (AICPA) is a not-for-profit entity that has provided guidance to its almost 400,000 accountant and auditor members across 128

[5] Sustainability is a broad term that is equally applicable to governments and businesses. The term incorporates social, environmental, and financial concerns. It is used when measuring an organization's ability to create products or services that meet the needs of today without impacting the ability of future generations to meet their needs and using accrual accounting to do so.

countries for more than 125 years. The AICPA sets *auditing* standards for its members; it does not set *accounting* standards. However, it is in the AICPA's *Professional Standards*[6] and *Statements on Auditing Standards* that it designates the authoritative accounting standards setters for each sector of the economy, as shown in table 2—Financial Accounting Standards Board (FASB), Governmental Accounting Standards Board (GASB), and Federal Accounting Standards Advisory Board (FASAB).[7]

Table 2. Accounting Standards Setters in the United States

Financial Accounting Foundation (FAF) finances and oversees			GAO, OMB, and US Treasury agencies finance and oversee
FASB www.fasb.org		GASB www.gasb.org	FASAB www.fasab.gov
Business Sector Entities with owners that expect a return on investment	**Not-for-Profit Sector** Entities without owners that serve the public or its members	**Public Sector** State and local governmental units with the power to tax citizens to provide public services, including NPOs that are controlled and funded by local governments	**Public Sector** The federal government and its agencies and instrumentalities

Note: GAO is the Government Accountability Office at www.gao.gov; OMB is the Office of Management and Budget at www.omb.gov.

The AICPA also prescribes language in its Statements on Auditing Standards (SASs) that auditors should use in the Audit Report that becomes an integral part of audited financial statements. This report is prepared at the culmination of an audit and includes the auditor's opinion about whether the financial statements (1) present fairly the financial position and the

[6] The AICPA's *Professional Standards* (June 2014) is a comprehensive source of auditing and attestation pronouncements. It includes the Code of Professional Conduct.
[7] American Institute of Certified Public Accountants (AICPA), Rule 203, Code of Professional Conduct in *Professional Standards*, June, 2014.

changes in financial position of the entity and (2) are in accordance with accounting principles generally accepted in the United States.

Until recently, the AICPA provided guidance to its auditor members as to what types of literature constituted GAAP and to what extent the auditor should rely on each type when evaluating whether an accounting treatment of an issue conformed to GAAP. The AICPA's SAS No. 69 (later revised in SAS No. 91) provided a GAAP hierarchy that showed four categories of literature ranked from the most authoritative, category (a)—which includes FASB, GASB, and FASAB statements—to the least authoritative, category (d)—which includes academic literature. The GAAP hierarchy was eventually shifted to the accounting literature from the AICPA audit literature when the FASB issued Statement of Financial Accounting Standard (SFAS) No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (2008). The FASB's *Accounting Standards Codification* (ASC) in 2009 made clear that from this point forward everything in the ASC is GAAP for businesses and NPOs while literature outside of the ASC is not GAAP.

Although the GASB had a Codification for a long time, it did not bring the hierarchy into its accounting literature until 2009 with GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.* A recent GASB Exposure Draft (ED) would reduce its four categories of GAAP to two and supersede GASBS 55. The two categories would be

1) GASB Statements and GASB Interpretations
2) GASB Implementation Guides, GASB Technical Bulletins, and any AICPA literature cleared by the GASB.

The GASB's ED keeps the door open to include AICPA guidance, such as the Audit and Accounting Guides on *State and Local Governments*, *Not-for-Profit Entities*, and *Health Care*

Entities as category (b) GAAP. The AICPA's guidance on other comprehensive bases of accounting (OCBOA), such as cash basis, modified cash basis, tax basis, regulatory basis, and contractual basis, is by definition "other" and not GAAP. However, many small governments that do not go to the bond market for financing and therefore do not need an unqualified audit opinion on their financial statements find this AICPA literature helpful. Showing the symmetry among the three standards setters, the FASAB issued its own Statement of Federal Financial Accounting Standard (SFFAS) 34, *The Hierarchy of Generally Accepted Accounting Principles, Including Application of Statements* to bring the hierarchy into federal accounting literature.

Accountants clearly delineate between accounting and auditing issues, which is an orderly way to separate the technical functional areas of preparing and auditing financial information. Government stakeholders, such as taxpayers, employees, oversight bodies, and community businesses who are potential users of financial information, do not likely make this distinction. They may not distinguish between the Audit Report that leads off the financial section of the Comprehensive Annual Financial Report (CAFR) and the subsequent financial statements. Recent efforts by the AICPA in their Clarity Project[8] to restate auditing standards to be more clear and understandable does benefit preparers and users alike. The AICPA also integrates into its literature the auditing standards of the Public Companies Accounting Oversight Board (PCAOB)[9] that was established by the Sarbanes-Oxley Act of 2002 to enhance the quality of information available to decision makers. Users of financial statements may also notice in the Audit Report that the auditors followed, not only generally accepted auditing standards (GAAS)

[8] The AICPA's Clarity Project in 2011 resulted in SAS No. 122, *Clarification and Recodification of U.S. Auditing Standards*, designed to enhance convergence with International Standards on Auditing and standards of the International Auditing and Assurance Standards Board (IAASB).
[9] The Sarbanes-Oxley Act of 2002 established a quasi-governmental auditing body in the Public Companies Accounting Oversight Board in the aftermath of auditing failures in the 1990s at Enron, WorldCom, Tyco, Arthur Andersen, and others. The PCAOB has authority to set accounting and auditing standards as they affect publicly traded companies.

established by the AICPA, but also generally accepted *government* auditing standards (GAGAS) established by the Government Accountability Office (GAO).[10]

2.1. ***Objectives of US Accounting Standards Setters***

Having covered the process of setting *auditing* standards in the previous section, we now turn to the authoritative *accounting* standards setters and the processes they follow in issuing GAAP. The overarching objective for having a set of accounting standards for any entity is to ensure that financial statements are understandable and, therefore, useful in making decisions. As stated in his outgoing article after serving for 10 years as chairman of the FASAB, David Mosso said, “An accounting standards setter does not create a road map so much as a vision for accountability, decision-making and reporting in the future” (2006). Over the years, best practices in the process of setting GAAP have developed across the three sectors in the US economy. The result is that the objectives of setting accounting standards and the due process for doing so are fairly similar across the organizations in table 2.

Each of the standards setters has a set of Concepts Statements that provide guiding principles in setting GAAP. The Concepts Statements embody qualitative characteristics for financial statements, such as understandability, relevance, reliability, and comparability, to guide their deliberations in setting standards. Relevance refers to whether the issue at hand will make a difference in a user’s decision making. Reliability generally refers to how well an issue or economic event is measured, and further, whether different preparers would measure an event similarly. Kadous, Koonce, & Thayer (2012) performed research experiments on how decision makers think about relevance and reliability in the context of fair value accounting standards and

[10] Generally accepted government auditing standards are embodied in the GAO’s publication, *Government Auditing Standards* (commonly known as “the yellow book” for the color of its cover since 1972).

conclude that users do not consider them independent constructs. Interestingly, the authors find that the factors underlying reliability influence how people think about relevance; however, the factors underlying relevance do not influence judgments of reliability. This finding is particularly important when measurements in reliability vary widely, as that affects what people think about the relevance of the measure. Accounting researchers further explore the use of financial statements for valuation in "value relevance literature" and the use of financial statements in contracts in "reliability focused literature" (Holthausen & Watts 2001; Barth, Beaver & Landsman 2001; Benston, et al. 2007). Different opinions exist as to whether the orientation of financial reporting should be on the balance sheet or shift to the income statement where the concept of income is clearer than the concept of assets (Dechev 2008).

We look at the three primary accounting standards setters in the United States in order to understand their objectives as embodied in each of their conceptual frameworks.

2.1.1. Financial Accounting Standards Board. The business sector looks to the FASB for guidance as do not-for-profit organizations that are not governmental in nature. The FASB is based in Norwalk, Connecticut, and is overseen by the Financial Accounting Foundation and its board of trustees. The FAF appoints the seven FASB members[11] and provides financing to the organization (Colson et al. 2009). The FASB has had responsibility for setting standards for businesses since it was established in 1973 as a smaller full-time successor to the AICPA's Accounting Principles Board (1959–1973) and before that, the AICPA's Committee on Accounting Procedures (1939–1959). The mission of the FASB as displayed on its website (www.fasb.org) is to

[11] FASB members are appointed for five-year terms, renewable one time. They serve full-time and sever ties with the organization they were at prior to appointment in order to foster independence in substance and appearance.

> establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports.

FASB's Concepts Statements[12] (SFAC Nos. 1 through 8, now codified in the *Accounting Standards Codification*) laid the groundwork for developing standards that result in understandable and useful financial information.[13] Topics in the FASB Concepts Statements include the general purpose of financial reporting and the qualitative characteristics of financial information. Statements must be presented with representational faithfulness[14] to the underlying economic condition of the organization. This faithfulness includes being relevant, defined as having the potential to make a difference in a decision, and reliable, defined as being verifiable (i.e., different accountants should be able to come up with similar numbers in capturing a transaction).

The FASB's specific role concerning nonbusiness entities is explained in its Concepts Statement No. 4 on nonbusiness entities (1980), which states that standards are intended to provide information that is useful for the following activities:

- Make resource allocation decisions.
- Assess the ability to provide services.
- Assess management's stewardship of assets and performance.
- Assess economic resources, obligations, net resources, and changes in them.[15]

The FASB's *Accounting Standards Codification* now serves as the source of GAAP for the business and private not-for-profit sectors of the US economy.

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[12] FASB's full name for their Concepts Statements is Statements of Financial Accounting Concepts (SFAC).
[13] Topic 105 in the *Accounting Standards Codification* is on generally accepted accounting principles. The *Codification* is a database and research system that pulls together resources about accounting standards into a searchable, topic-oriented system.
FASB ASC Topic 105, Generally Accepted Accounting Principles.
[14] Representational faithfulness is a term the FASB and International Accounting Standards Board (IASB) settled on in 2005 to capture the concepts of relevance and reliability (Kadous, Koonce & Thayer 2012, 1336).
[15] FASB ACS 105, Generally Accepted Accounting Principles.

2.1.2. Governmental Accounting Standards Board. The GASB was created in 1984 when it was determined that a full-time paid board would be more effective at setting standards than the part-time volunteer National Council on Governmental Accounting (NCGA).[16] The GASB is located in the same building as the FASB in Norwalk, Connecticut, and is also overseen by the FAF, although the funding mechanism for each is different. The GASB is responsible for financial reporting standards for state and local governments, but not for federal agencies. The GASB has sought to "describe the unique nature of governmental entities and the distinguishing characteristics of the environment they operate in" (Attmore 2009).

The GASB, like the FASB, provides information primarily intended to be useful to external decision makers, not internal managers. A government's responsibility to be accountable derives from the public's "right to know." Accountability is the cornerstone of government financial reporting.[17] The GASB's Concepts Statement No. 1 (1984) identifies objectives of external financial reporting:

- Demonstrate public officials' accountability to citizens for raising public monies and determining how they are spent.
- Compare actual financial results with the legally adopted budget.
- Assess financial condition and results of operations.
- Assist taxpayers in determining compliance with finance-related laws, rules, and regulations, including the budget.
- Assist taxpayers in evaluating efficiency and effectiveness.

[16] The National Council on Governmental Accounting was established in 1948 to replace the National Committee on Municipal Accounting in place since 1934. (Chan 1985).
[17] GASB Codification B (p. B-21). GASB Concepts Statement No. 1, par. 56.

- Assess inter-period equity: Are current-year financial resources sufficient to pay for current-year services provided to citizens, or will future taxpayers have to pay for services provided to current taxpayers?

The GASB's purview includes not only state and local governments but also any not-for-profit organization that is primarily governmental in nature because of the control a government exercises over it.[18]

The GASB's Concepts Statements Nos. 1 through 5 (also included in its Codification and Governmental Accounting Research System (GARS) includes a framework for the elements of financial reports: assets, liabilities, net position, inflows and outflows of resources, and deferred inflows and outflows of resources. The Concepts Statements also include the goal to "assist in evaluating efficiency and effectiveness" on which the GASB bases its exploration of "service efforts and accomplishments."

There are two points of view regarding the scope of the GASB's standards-setting authority: the "constrained perspective" and the "expansive perspective." These two perspectives spark debates about whether the GASB's standards-setting authority is limited to information rooted in financial transactions (constrained perspective) or whether the GASB's authority extends to the reporting of service performance (expansive perspective), which is beyond the traditional scope of GAAP and the GASB (Klay & McCall 2005).

[18] Examples of not-for-profit organizations that may be treated as governmental units are museums, libraries, and research foundations. Another example is a fundraising or alumni foundation that may be an Internal Revenue Code Section 501(c)3 private organization incorporated under the nonprofit corporation laws of a state but receiving a significant portion of its funding from a governmental entity that is responsible for its debts and appoints its board of directors.

2.1.3. Federal Accounting Standards Advisory Board. The FASAB is a nine-member body that three federal agencies established in 1990 as a federal advisory committee to set standards for the federal government's consolidated financial statement (first issued in 1980) and the individual financial statements of its agencies and instrumentalities. The three sponsoring federal agencies are the Office of Management and Budget and Department of Treasury from the executive branch and the Government Accountability Office from the legislative branch, which operates as the independent auditing arm of Congress. The FASAB has a responsibility to ensure that the impact of the federal government's fiscal policy decisions is clearly and understandably reflected in its financial statements (Allen 2008).

The FASAB's Statements of Federal Financial Accounting Concepts Nos. 1 through 7 include guidance on the entity on which to report, how to display financial information, and the Management's Discussion and Analysis (MD&A). Concepts Statement No. 1 says that financial reporting should help users evaluate the following elements of the federal government and its agencies:

- budgetary integrity
- operating performance
- stewardship
- adequacy of systems and controls

FASAB's financial reporting objectives are anchored in accountability but go further than the GASB by targeting *both* internal users (management) and external users. What results is an integrated financial and performance report. Federal inspectors general that audit these reports follow *Government Auditing Standards* (the yellow book). State and local governments that receive federal funds will see that the Audit Report indicates that the auditor followed generally accepted auditing standards (GAAS) and generally accepted government auditing standards (GAGAS).

2.2. *Due Process of Setting Standards*

All three standards setters follow a similar process that can be traced back to the Committee on Accounting Procedures set up by the AICPA in 1939 credited with being the first standards-setting body for businesses. Around this time Professors William A. Paton from the University of Michigan and A. C. Littleton from the University of Illinois[19] wrote about the need to standardize the measurement and reporting of financial information about businesses in American Accounting Association Monograph No. 31940. Standardization evolved into the concept of "generally accepted," and thus accounting standards are now referred to as generally accepted accounting principles (GAAP).[20] GAAP is not a science, there is no exhaustive list of principles; rather, accounting is a social science and GAAP are based on a due process of input from a multitude of stakeholders that evolves over time. Neither is GAAP a set of regulations; however, when a governing body requires GAAP to be used in statutory filings, this requirement carries the force of regulation. For example, a state may require local governments to submit an annual financial report that conforms to accounting principles generally accepted in the United States, or the federal government may require state and local governments that receive and expend more than $500,000 of federal financial assistance to have a Single Audit that includes a report by an auditor that the organization has complied with GAAP.

[19] In their 1975 tribute to A. C. Littleton, N. M. Bedford and R. E. Ziegler reported that Littleton and Paton served on the Committee on Accounting Procedures in 1938 and spearheaded the AICPA's major step forward to formulate accounting principles based on theoretical academic study of accounting issues (p. 438).

[20] The Institute of Management Accountants makes a distinction between its "principles" of honesty, fairness, objectivity, and responsibility, which are not observable, and its "standards" of competence, confidentiality, integrity, and credibility, which are observable and measurable in its *Statement of Ethical Professional Practice*. See http://www.imanet.org/resources_and_publications/EthicsCenter.aspx.

Due process in setting standards means that the public at large and the accounting industry have an opportunity to provide input at multiple stages in the process through comment letters and open hearings. There are certain major steps in the process for almost every agenda project across all three standards setters. These steps include the following:

- issue identification
- the agenda decision
- development of an agenda project
- practical considerations in developing a standard
- post-issuance effects (Reither 1997).

The FASB *Rules of Procedure* describe the FASB process of setting a technical agenda, soliciting input from a broad set of stakeholders, operating with its staff and a 35-member advisory board, and communicating with the public in a spirit of transparency. As described on the FASB website (www.fasb.org) in the section on the Standards-Setting Process, "A key principle guiding the Board's work is to issue standards when the expected benefits of a change justify the perceived costs of that change." The FASB's due process follows these steps:

1) The Board identifies financial reporting issues based on requests or recommendations from stakeholders or through other means.
2) The FASB decides whether to add a project to the technical agenda based on a staff-prepared analysis of the issues.
3) At one or more public meetings, the Board deliberates the various reporting issues identified and analyzed by the staff.
4) The Board issues an Exposure Draft to solicit broad stakeholder input. (In some projects, the Board may issue a Discussion Paper to obtain input in the early stages of a project.)

5) The Board holds a public roundtable meeting on the Exposure Draft, if necessary.
6) The staff analyzes comment letters, public roundtable discussion, and all other information obtained through due process activities. The Board redeliberates the proposed provisions, carefully considering the stakeholder input received at one or more public meetings.
7) The Board issues Accounting Standards Updates describing amendments to the *Accounting Standards Codification*.

The FASAB and GASB follow similar steps. The GASB has a 29-person Advisory Council (GASAC) that helps identify and prioritize research issues to be placed on either the current technical agenda, pre-agenda research, monitoring activities (e.g., emerging issues), or potential projects agenda. The following GASAC members represent a diverse set of stakeholders that prepare, use, and attest to financial statements.

- American Accounting Association (AAA)
- American Institute of Certified Public Accountants (AICPA)
- American Public Power Association (APPA)
- Association for Budgeting and Financial Management (ABFM)
- Association of Financial Guaranty Insurers (AFGI)
- Association of Government Accountants (AGA)
- Association of Local Government Auditors (ALGA)
- Association of School Business Officials International (ASBOI)
- Bond Raters (currently from Standard & Poor's)
- Council of State Governments (CSG)
- Government Finance Officers Association (GFOA)

- Government Research Association (GRA)
- Healthcare Financial Management Association (HFMA)
- Insurance Industry Investors (currently State Farm Insurance Company)
- International City/County Management Association (ICMA)
- Investment Company Institute (ICI)
- National Association of Bond Lawyers (NABL)
- National Association of College & University Business Officers (NACUBO)
- National Association of Counties (NACo)
- National Association of State Auditors, Comptrollers & Treasurers (NASACT)
- National Association of State Budget Officers (NASBO)
- National Association of State Retirement Administrators (NASRA)
- National Conference of State Legislatures (NCSL)
- National Federation of Municipal Analysts (NFMA)
- National Governors Association (NGA)
- National League of Cities (NLC)
- Native American Finance Officers Association (NAFOA)
- Securities Industry and Financial Markets Association (SIFMA)
- US Census Bureau
- US Conference of Mayors
- Official Observer: Comptroller General of the United States, Government Accountability Office

Three times a year the GASAC meets to review accounting issues at each stage of the agenda and to receive updates from the GASB's research director and project managers. The staff reports on public responses to its public hearings, Invitations to Comment, and Preliminary Views on documents such as Exposure Drafts of prospective statements. Final statements result from this comprehensive and inclusive process. Although each of the standards setters follows a principles-based process of setting standards rather than a rules-based process, the GASB does support its constituents with a Comprehensive Implementation Guide (updated at least annually) that may be perceived as a book of rules in the form of questions and answers. The GASB also publishes User Guides[21] that provide guidance in implementing and understanding GAAP.

Although the three standards setters follow a parallel process of deliberating accounting issues, each one is responsive to its own set of stakeholders who have different needs for financial reports. A 2006 National Research Center, Inc., survey revealed that GASB "constituents overwhelmingly believe that governmental accounting standards should be different from private-sector standards because of the environmental differences and unique characteristics of government" (Attmore 2006). However, even within diverse stakeholder groups, there are varying opinions on how financial information can be most useful. Standards setters must objectively and systematically consider the needs of all their constituents in making informed decisions about how accounting information can be most useful.

2.3. *Other Standards Setters*

In addition to the FASB, GASB, and FASAB, auditors and preparers of financial reports must be cognizant of other organizations that refer to GAAP. The Securities and Exchange Commission (SEC) has federal authority to set accounting standards for securities offered for public

[21] (Mead 2012–2013). Titles include *What You Should Know about Your Local Government's Finances*, *What You Should Know about Your School District's Finances*, *An Analyst's Guide to Government Financial Statements*, and *What Else You Should Know about a Government's Finances*.

investment through the US stock exchange. The SEC has delegated authoritative support for setting accounting standards to the FASB for businesses[22] and the GASB for governments that offer municipal bonds for trade on the exchanges, unless the SEC issues a particular Accounting Series Release (ASR) on a topic available in the *Staff Accounting Bulletins Codification.*

In our global financial environment, organizations must keep an eye on international accounting standards initiatives. The International Accounting Standards Board (IASB) has issued International Financial Reporting Standards (IFRS), now adopted by more than 130 countries in the world.[23] While the SEC continues to deliberate on if and when it will require companies whose stock is traded on US stock exchanges to switch from US GAAP to IFRS, the FASB continues to work with the IASB in converging the US GAAP to IFRS. Each body has a commitment to working toward a single set of high quality accounting standards; however, the United States is not yet ready to replace US GAAP with IFRS (Sunder 2002).

Relevant to governmental accounting standards-setting is the work of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) to "enhance the quality, consistency, and transparency of public sector financial reporting worldwide (www.ifac.org/public-sector). Country-to-country convergence may not be easy when there are such obvious differences in size, scope of services, and politics (e.g., the United States compared to England or Germany or China); however, progress has been made at harmonization at the local government level (e.g., state, province, city, or town) across the globe.

[22] See Skousen, Glover, & Prawitt (2005) and SEC Financial Reporting Release No. 1, Sector 101, reaffirmed in the April 2003 Policy Statement.
[23] See the IFRS Foundation and IASB website at www.ifrs.org and AICPA resources on IFRS at www.ifrs.com.

3. State and Local Government Financial Reporting Model

The GASB's charge when formed in 1984 by the Financial Accounting Foundation was to reexamine the government financial reporting model. After 15 years of deliberation and due process the GASB issued Statement No. 34 (GASBS 34) in 1999, to be effective in 2001 for the largest governments with more time given to small and medium-sized governments. The revised model expanded the traditional fund accounting system that had been in place since the 1930s by adding two government-wide full accrual statements to ensure that users could see the big picture and assess inter-period equity. The term "state and local governmental GAAP" now refers to the GASBS 34 financial reporting model and subsequent GASB statements that address particular accounting issues.[24]

The GASBS 34 model is designed to serve a broad set of stakeholders who are expected to use financial statements to make decisions. These stakeholders include managers, citizens, bondholders, employees and their unions, residents, and governance bodies, such as city councils. These users have a "stake" in the governmental entity and will have different opinions about how scarce resources (supply) should be allocated to meet different requests (demand). One stakeholder group, *government managers*, is accountable for spending only what has been legally authorized by a city council or other governance body and for raising sufficient revenue in the current period so as not to burden the next generation with debt for current services. In an economic recession, government managers must decide what the government can afford to continue to do and which programs should be cut if budgets are to be balanced. *Municipal bondholders and prospective investors*, periodically evaluate the municipal bond proportion of

[24] Although GASB Statement No. 34 is now 15 years old and included in the GASB's Codification, it is such a monumental turning point in governmental GAAP that we use the acronym GASBS 34 throughout this paper to refer to the "new" financial reporting model.

their investment portfolios. *Citizens* decide whether or not to live in a city with a city income tax and whether to approve property tax increases at the voting booth.

The public often depends upon intermediaries to condense and filter information from financial statements. For example, when municipal bond raters (e.g., Moody's, Standard & Poor's, Fitch Ratings) evaluate whether to upgrade or downgrade a city, state, or federal government's bond rating, their action is a signal to all that the government's cost of capital will change, affecting not only citizens of that taxing jurisdiction but also investors in municipal bonds. The media also serve as a watchdog, following and reporting on governmental trends, legislation, and public finance activities of interest to citizens and residents of a geographic area. Arguably, stakeholders will make better short- and long-term decisions if they make data-driven decisions that are based on useful accounting information. The effectiveness of the GASBS 34 financial reporting model depends upon whether stakeholder groups actually access, read, analyze, and understand GAAP financial reports.

3.1. *The Government Accounting Cycle*

The first step in the accounting cycle that leads to GASBS 34 financial statements is to classify activities in which a government engages in order to provide public services to its citizens. The classifications are as follows:

- *governmental activities* (e.g., public safety, general government, parks and recreation),
- *business-type activities* that either citizens have demanded because they are difficult to acquire on their own (e.g., water and sewer, parking) or entrepreneurial ventures the government pursues (e.g., airports, golf courses), and

- *fiduciary activities* in which governments engage when they hold money for others as their agent (e.g., taxes collected on behalf of the local school system or pension contributions withheld from employees' paychecks).

These categories of activities are presented in table 3 as the first step in a process of recording transactions leading up to financial statements. The extent to which governments should be involved in each of these types of activities is a political discussion about the "right" size of government and which governments (i.e., federal, state, local) should provide certain services. For example, Medicaid is a program that is mandated at the federal level but funded and delivered at the state level. GAAP financial statements merely capture the economic and financial transactions in which the organization has chosen to engage.

Step 2 in the cycle is to record these transactions chronologically as they occur in journals such that the accounting equation stays in balance. For a business, the accounting equation is as follows: assets equals liabilities plus owners' equity (i.e., capital stock and retained earnings). Since there are no owners in a government, the equation is modified to read thus: assets equals liabilities plus net position/fund balance. The remaining steps in the cycle are to prepare financial statements at the fund level (step 3) make appropriate reconciliations in order to convert governmental funds information to governmental activities information (step 4), and prepare financial statements at the government-wide level (step 5).

Table 3. The State and Local Government Financial Reporting Process

1. Classify transactions into governmental, business-type, or fiduciary activities.
2. Record transactions as journal entries into appropriate funds based on their type of activity identified in step 1.
    a. Governmental funds include one General Fund, special revenue funds, debt service funds, capital projects funds, and permanent funds, all of which use the modified accrual basis of accounting.
    b. Proprietary funds include internal service funds and enterprise funds, both of which use the accrual basis of accounting.
    c. Fiduciary funds include agency funds, investment trust funds, pension trust funds, and private-purpose trust funds, all of which follow the accrual basis of accounting. After journalizing transactions, post entries to ledgers and prepare trial balances.
3. Prepare fund financial statements from trial balances.
    a. Fund statements for the governmental funds include a Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balance.
    b. Fund statements for the proprietary funds include a Statement of Net Position, Statement of Revenues, Expenses, and Changes in Net Position, and Statement of Cash Flows.
    c. Fund statements for fiduciary funds include a Statement of Fiduciary Net Position and a Statement of Changes in Net Position.
4. Convert governmental funds to governmental activities. Adjust for differences between modified accrual and accrual basis of accounting. For example, examine the different treatment of capital assets and long-term debt transactions under each basis of accounting. No conversion of proprietary fund information to business-type activities is necessary because each uses the accrual basis of accounting.
5. Prepare government-wide statements which are a Statement of Net Position and a Statement of Activities. Each statement will include a column for governmental activities (converted from governmental fund information in step 4) and one for business-type activities, but no column for fiduciary activities. Internal service fund information, although coming from a proprietary fund, will be presented in the governmental activities of the government-wide statements owing to the exclusive services offered to the government. These statements are prepared on the accrual basis of accounting.

3.2. *Comprehensive Annual Financial Report*

GASBS 34 presents the components of a CAFR, which is recommended but not required. The CAFR is usually a large, spiral-bound booklet that may be upwards of 200 pages long for large cities.[25] It is often posted on a government's website in the finance department's tab as a PDF file. A CAFR includes the following three sections:

1) An **introductory section** that includes a title page and transmittal letter from the city manager or mayor to the city council or other governing body. Governments often include a Certificate of Excellence in Financial Reporting for the past year's financial report if one had been awarded from the Government Finance Officers Association.
2) A **financial section** that includes an auditor's report, general-purpose external financial statements, and other supplementary information. The general-purpose external financial reports are the required minimum financial statements. They include the following:
    - Management's Discussion and Analysis (MD&A)
    - basic financial statements:
        - two government-wide financial statements
        - seven fund financial statements (for the 11 fund types described later)
        - notes to the financial statements
    - required supplementary information (RSI) other than MD&A
3) A **statistical section** that includes financial, revenue capacity, debt capacity, demographic, and economic and operating trends (GASB Cod. Sec. 2800).

This CAFR reports on the primary government, such as a city, and its component units. Component units are governmental or not-for-profit entities over which the primary government exerts significant influence and responsibility. The city may provide funding, appoint the board, and be ultimately responsible for the debts of a local museum, library, economic development authority, transportation authority, cemetery board, or brownfield redevelopment authority. In

[25] The city of Detroit's CAFR for the fiscal year ending June 30, 2013, is 248 pages long.

these cases, the reporting entity should include the primary government and all its component units in order to provide a complete picture.

The key to understanding the government financial reporting model is to accept that preparers and standards setters have found that users have different perspectives on what the government's financial statements should measure. These differences generally fall into one of two perspectives: long-term operational accountability and short-term fiscal accountability, both equally valid.

The long-term flow of economic resources in and out of the government measures *operational accountability.* Full accrual accounting used by businesses is the most appropriate basis of accounting to use in determining the cost of governmental programs and services along with related revenues for a specific time period for this perspective. Government-wide statements use this measurement focus and use the accrual basis of accounting, as well as proprietary and fiduciary funds (discussed later in this section).

The short-term flow of current financial resources in and out for governmental activities measures *fiscal accountability*. This perspective recognizes the importance of the annual General Fund budget. A modified accrual basis of accounting is most appropriate in revenues that are recognized when they are "measurable and available" and not when they are "earned" and expenditures are recognized when appropriations are "expended," rather than when they are "incurred." The General Fund and other governmental fund types focus on fiscal accountability and use modified accrual accounting.

GASBS 34 integrates these two different perspectives in the reporting model. The big picture is presented using the accrual basis of accounting in two government-wide financial statements. To show that fund financial statements are equally important, they are presented side by side in the GASBS 34 graphic, but, practically, the government-wide statements are presented before the fund statements. The excerpt from the Benton Harbor Area Schools audited annual budget in figure 1 provides readers with a guide for using the financial report.

Figure 1. Excerpt from Benton Harbor Area Schools Audited Annual Report, FY 2011

Using this Annual Report

This annual report consists of a series of financial statements and notes to those statements. These statements are organized so the reader can understand Benton Harbor Area Schools financially as a whole. The government-wide financial statements provide information about the activities of the whole School District, presenting both an aggregate view of the School District's finances and a longer-term view of those finances. The fund financial statements provide the next level of detail. For governmental activities, these statements tell how services were financed in the short term as well as what remains for future spending. The fund financial statements look at the School District's operations in more detail than the government-wide financial statements by providing information about the School District's most significant funds - the General Fund and Capital Projects - Sinking Fund, with all other funds presented in one column as nonmajor funds. The remaining statement, the statement of fiduciary net position, presents financial information about activities for which the School District acts solely as an agent for the benefit of students and parents.

Management's Discussion and Analysis (MD&A)
(Required Supplemental Information)

Basic Financial Statements
Government-wide Financial Statements Fund Financial Statements
Notes to the Basic Financial Statements

(Required Supplemental Information)
Budgetary Information for Major Funds

Other Supplemental Information

Reporting on the School District as a Whole: Government-Wide Financial Statements

One of the most important questions asked about the School District is, "As a whole, what is the School District's financial condition as a result of the year's activities?" The statement of net assets (deficit) and the statement of activities, which appear first in the School District's financial statements, report information on the School District as a whole and its activities in a way that helps you answer this question. We prepare these statements to include all assets and liabilities, using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

Source: http://bhas.org/cms/lib07/MI01001281/centricity/domain/27/Audit%20Reports/BHAS_Annual_report_06302011.pdf.

A common misunderstanding is to think the funds statements—in contrast to the government-wide statements—measure the short-term perspective. But, as described earlier, it is only the governmental funds that focus on the short term. The proprietary and fiduciary funds focus on the long term and use accrual accounting.

3.3. *Government-Wide Financial Statements*

The pair of government-wide, full accrual statements in the GASBS 34 financial reporting model include a statement of net position that reports on the balances in assets, liabilities, and net position at a point in time and a statement of activities that reports on the changes in net position over time (usually a month or a year). Both governmental and business-type activities of the government as a whole are presented in these statements. Fiduciary activities do not appear in either statement because they are seen as assets belonging to people and organizations outside of the reporting entity, thus including these would merely inflate assets and liabilities of the reporting entity. Academic research into the incremental value of GASBS 34's government-wide statements shows that the bond market does value accrual-based information (Reck & Wilson 2014; Plummer, Hutchison & Patton 2007; Pridgen & Wilder 2013).

3.3.1. Statement of net position. Although this statement is much like a balance sheet for a business in that it reports on balances in permanent accounts (i.e., assets, liabilities, net position) and shows that the accounting equation is in balance as of the end of the accounting period, reordering the presentation to be assets less liabilities focuses attention on the residual amount: net position. In 2011, GASB introduced the term "net position" (one used in federal agencies) into the financial reporting model to replace the term "net assets."[26] Assets still equal the sum of liabilities and net position, so the accounting equation is in balance, but this format draws attention to the net position and its classifications of unrestricted, restricted, and net investment in capital assets (i.e., capital assets, net of the related long-term debt), as shown in table 4.

Table 4. Illustrative Statement of Net Position

XYZ Government
Statement of Net Position as of December 31, 2015

	Governmental activities	Business-type activities	TOTAL
Assets			
Cash	$310,000	$15,000	$325,000
Taxes receivable	700,000		700,000
Capital assets	800,000	39,000	839,000
Total assets	1,810,000	54,000	1,864,000
Liabilities			
Vouchers payable	85,000	2,000	87,000
Bonds payable	200,000	0	200,000
Total liabilities	285,000	2,000	287,000
Net position			
Unrestricted	**675,000**	**47,000**	**722,000**
Restricted	250,000		250,000
Net investment in capital assets	600,000	5,000	605,000
Total net position	$1,525,000	$52,000	$1,577,000

When liabilities are greater than assets, then the unrestricted position (shown in bold in table 4) is negative and should be restated as "deficit". Unrestricted net position can be thought of as the accrual-based "rainy day fund" for the government as a whole, although that concept is usually associated with the General Fund.

[26] GASBS 63 *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, (June, 2011), GASB Codification Sec. 2200.109–117.

3.3.2. Statement of activities. This statement is a very innovative presentation that provides the full cost of functional programs demanded by citizens in the first column, followed by revenues dedicated to those programs to the right, resulting in a net expense or cost of programs (presented as a negative number), as shown in table 5. Reading down from net expense in governmental activities toward the bottom of the statement, we see general revenues (e.g., property or income taxes or investment income) that must be found to cover the cost of those governmental programs. The difference between expenses and program revenues and general revenues is the "change in net position", which is added to (or subtracted from) the beginning net position balance to arrive at ending net position. It is this number that is carried forward to the statement of net position for the current period. The change in net position can be thought of as comparable to net income for a business; it is the result of operations and other nonoperating items (e.g., investment income) over a certain period of time.

Expenses are reported by the functional program—such as general government, public safety, or parks and recreation—rather than by line item (e.g., salaries, travel, and depreciation). These expenses are either (1) directly associated with a function or program or (2) indirectly related, such as interest expense, which is then shown on a separate line rather than being allocated to functions. Revenues are classified as either (1) program revenues, which are charges for services, operating grants, and capital grants that are dedicated to advance programs, or (2) general revenues, which are not directly linked to any program or function. General revenues can be found at the lower portion of the statement of activities. Other items that could be presented in this area are extraordinary items, which are both unusual in nature and infrequent in occurrence, and special items, which meet one but not both of those criteria. The sale of capital assets, such as land and buildings, is another type of general revenue that will appear in this section as it is available to cover the cost of operating governmental programs. Governments may find it necessary to sell off capital assets, such as land and buildings, to balance their annual budget, although clearly this is "one-time" money that will not be available in future years.

Table 5. Illustrative Statement of Activities

XYZ Government
Statement of Activities for the Year 2015

Functions	Expenses	Program revenues			Net (expense) revenue and changes in net position		TOTAL
		Charges for services	Operating grants	Capital grants	Governmental activities	Business-type activities	
Governmental activities							
General government	$60,000	$2,000			($58,000)		($58,000)
Public safety	15,000		$1,000		(14,000)		(14,000)
Parks & recreation	9,000			$2,000	(7,000)		(7,000)
Interest expense	1,000				(1,000)		(1,000)
Total governmental activities	$85,000	$2,000	$1,000	$2,000	($80,000)		($80,000)
Business-type activities	15,000	17,000				2,000	2,000
TOTALS	$100,000	$19,000	$1,000	$2,000	(80,000)	2,000	($78,000)
	General Revenues						
	Property taxes				100,000		100,000
	Special items				5,000		5,000
	Change in net position				25,000	2,000	27,000
	Net position at beginning				1,500,000	50,000	1,550,000
	Net position at end				$1,525,000	$52,000	$1,577,000

Source: Based on GASBS 34, 1999, ¶ 54.

An alternative format that is increasingly used by governments in order to avoid problems a page with landscape orientation can have in PDF[27] is shown in table 6, where the statement is

[27] A statement of activities that is presented in landscape orientation as two adjacent pages in a spiral-bound hard copy of a CAFR often presents in a PDF on a website as two (or four) pages, one after the other where the second

split into two parts. In the upper part of the table, totals are drawn in the far right column for the net (expense) or revenue of each governmental and business-type activity. In the lower part of the table those totals are presented as the first row of numbers. In this format there is never confusion about row labels, and it provides an added benefit of focusing in the second part on how the net (expense) revenue is funded and how the change affects the statement of net position.

Table 6. Illustrative Statement of Activities (alternative format)

Functions	Expenses	Program revenues: Charges for services	Program revenues: Operating grants	Program revenues: Capital grants	Net (expense) revenue
Governmental activities					
General government	$60,000	$2,000			($58,000)
Public safety	15,000		$ 1,000		(14,000)
Parks & recreation	9,000			$2,000	(7,000)
Interest expense	1,000				(1,000)
Total governmental activities	$85,000	$2,000	$1,000	$2,000	($80,000)
Business-type activities					
	15,000	17,000			2,000
TOTALS	$100,000	$19,000	$1,000	$2,000	($78,000)

	Governmental activities	Business-type activities	TOTALS
Net (expense) revenue	($80,000)	$2,000	($78,000)
General revenues			
Property taxes	100,000		100,000
Special items	5,000		5,000
Total revenue	105,000		105,000
Change in net position	25,000	2,000	27,000
Net position at beginning	1,500,000	50,000	1,550,000
Net position at end	$1,525,000	$52,000	$1,577,000

Source: CAFR of the City of Lansing, Michigan, for FY 2014, pp. 33–34, www.lansingmi.gov/media/view/FY2014CAFR/7635.

(and fourth) page is without the information listed on the left of the table. This presentation makes it very difficult for a reader to attach meaning to the numbers on the second page.

3.4. *Fund Financial Statements*

GASB's members were responsive to stakeholders who felt strongly that short-term budget information should continue to be as important as it had been since funds were described by the NCGA in the 1930s.[28] Funds are defined as accounting entities and fiscal entities. *Accounting entities* are funds that each have their own accounting information system in which the steps of the monthly accounting cycle lead to the preparation of financial statements. *Fiscal entities* are funds for which the temporary accounts are closed out at the end of a period of time (either a month or year) to some permanent account on the balance sheet (e.g., fund balance). The design of the fund accounting structure allows a manager to account for different types of resources and related expenses in different funds (sometimes imagined as keeping track of money in shoe boxes) to facilitate accountability for those funds back to the resource provider. Some governments may open a separate bank account for each fund to further protect the integrity of restricted funds; however, best treasury practices may suggest consolidating cash and investments to maximize investment return and minimize fees. The account number in an accounting information system can attach to funds their fair share of cash even though it is centrally invested and managed.

Budgets are important for any entity; however, governmental budgets are legal documents approved by legislative bodies. Funds continue to be recognized as the accounting structure that bests enables comparisons of actual spending on governmental activities to that which was legally appropriated in the annual budget. Focusing on matching actual results to a one-year budget leads very much to a cash basis (or at least modified accrual basis) way of

[28] The Municipal Finance Officers Association (MFOA) first established the National Committee on Municipal Accounting in the 1920s, which was then succeeded by the National Committee on Governmental Accounting, which in turn was replaced by the National Council on Governmental Accounting (NCGA) in 1974.

thinking. The funds that have legally approved budgets are those that capture governmental activities. The fund structure established in the NCGA's *Government Accounting, Auditing, and Financial Reporting* (GAAFR)[29] sets out three fund types that correspond to the three types of activities in which governments engage: governmental, business-type, and fiduciary. Five governmental funds capture governmental activities, two proprietary funds capture business-type activities, and four fiduciary funds capture fiduciary activities. This set has changed somewhat over the years,[30] but the current version in GASBS 34 presents 11 different fund types as seen in subsections 3.4.1–3.4.3.

3.4.1. Governmental funds. These five funds are used to record typical activities in which the government is engaged, such as general government, public safety, culture and recreation.

- The **General Fund (GF)** is the primary fund that accounts for the general government operations, public safety, courts, parks and recreation, culture, and other basic public services. There must be one and only one General Fund, and its budget is a legal document.
- **Special revenue funds (SRFs)** are set up when special resources are provided that must be spent a certain way: for example, motor fuel tax revenue for road repair or forfeited assets in a drug raid for drug education programs.

[29] See S. Gauthier (2013). His book was originally issued in the 1930s and is still referred to as the GAAFR or Blue Book with reference to the color of its cover. Each revision reflects changes in generally accepted accounting principles as promulgated by the Government Accounting Standards Board, available at http://www.gfoa.org /publications.
[30] At one time, special assessment funds were used to capture the activity that resulted when a group of citizens petitioned the government to improve its streets or sidewalks and were willing to pay increased taxes to cover the cost. That activity is now captured in the Capital Projects Fund (for construction on the streets), Debt Service Fund (to pay the interest and principal on debt if any was issued to get the funds to improve the streets), and General Fund (to recognize the increased tax revenue from citizens benefitting from the improvements).

- **Capital projects funds (CPFs)** are used to account for the acquisition or construction of long-term capital assets, such as a city building or the replacement of computers.
- **Debt service funds (DSFs)** may be required for bond issues and are used solely to account for the principal and interest payments on long-term debt.
- **Permanent funds (PFs)** account for long-term endowments by a donor on which the earnings are for the benefit of the government.

3.4.2. Proprietary funds. These two funds are business-like in that there is a determination of net income.

- **Internal service funds (ISFs)** are established to account for business-type activities for which the customers are departments of the government: for example, motor pools, self-insurance funds, and copy centers.
- **Enterprise funds (EFs)** are set up to account for business-type activities for which the customers are external to government departments, such as airports, golf courses, and water and sewer services.

3.4.3. Fiduciary funds. These four funds are held by the government for the benefit of others.

- **Agency funds (AFs)** are used to account for holding assets that belong to employees (e.g., payroll taxes) or other governments (e.g., taxes).
- **Investment trust funds (ITFs)** account for funds held and invested for other funds within the government or funds of other governments.
- **Private-purpose trust funds (PPTFs)** are established to account for endowments by donors on which the earnings are restricted in order to benefit people outside the

government, such as educational benefits for the family members of public safety officers hurt or killed on the job.

- **Pension trust funds (PTFs)** account for public employee retirement systems and other postemployment benefit systems.

3.4.4. Fund elements and statements. The government can provide a descriptive name for any fund (other than the General Fund) within those fund types: for example, Main Street Improvement Fund would be a capital projects fund, Workers Compensation Fund would be an internal service fund, and Police and Fire Benevolent Fund would be a private-purpose trust fund.

The difference between assets and liabilities in the governmental funds is called the fund balance. The GASB replaced the terms "unreserved and reserved" as classifications of fund balance that had been used since the 1930s with "spendable and nonspendable" in 2009.[31] If the fund balance is spendable, it is further described by the level of restriction placed on it by external bodies or the governing body (i.e., restricted, committed, or assigned) with the residual called an unassigned, spendable fund balance.

In Step 3 of the accounting cycle road map shown in table 3, financial statements are prepared from journal entries made into the funds, then posted to ledgers, and summarized in trial balances. These are the statements required for each type of funds:

- Governmental Funds
    - Balance sheet
    - Statement of revenues, expenditures, and changes in fund balances

[31] GASBS 54 is *Fund Balance Reporting and Governmental Fund Balance Definitions* (February 2009), or GASB Codification 800, ¶¶ 166–77.

- Proprietary Funds
  - Statement of net position
  - Statement of revenues, expenses, and changes in fund net position
  - Statement of cash flows[32]
- Fiduciary Funds
  - Statement of fiduciary net position
  - Statement of changes in fiduciary net position

The only type of funds requiring a statement of cash flows are the proprietary funds. GASB believed that governmental funds' use of the modified accrual basis of accounting was sufficient to show short-term, cash-basis information. Requiring an additional cash flows statement would be an unnecessary burden.

In order to streamline the financial statements, GASBS 34 provides for columns presenting "major fund" information in the governmental and enterprise funds. All nonmajor fund information is aggregated into a single column called Nonmajor Funds. Major is a term used to indicate that the fund is either relatively large or significant enough to warrant its own column on the financial statements. The General Fund is always a major fund. There is a two-part test to determine whether a fund is large enough to be required to be labeled "major." Any governmental or enterprise fund that meets *both* of the following criteria is a major fund:

a) Total assets, liabilities, revenues, *or* expenditures of the fund are at least 10 percent of the corresponding element[33] total for all governmental or enterprise funds, as applicable, *and*

[32] Unlike FASB requirements that cash flow statements have three sections (operating, investing, and financing), the GASB requires a fourth section for noncapital financing activities for example, transfers between funds.
[33] An example of an element on a financial statement is assets, liabilities, revenues, or expenditures.

b) The same fund that met the 10 percent criterion in (a) is at least 5 percent of the corresponding element total for all governmental and enterprise funds combined.

In the example in table 7, governmental fund A is considered a major fund because the element "assets" is greater than 10 percent of total governmental funds ($550 > .10 × $1,000) and greater than 5 percent of total governmental and enterprise funds ($550 > .05 × $10,000). None of the four elements in governmental fund B, meet both tests; therefore, fund B is not a major fund.

Table 7. Illustration of Major Funds

Element	Governmental fund A	Governmental fund B	Total governmental funds	Total governmental and enterprise funds
Assets	$550	$220	$1,000	$10,000
Liabilities	$ 70	$210	$ 800	$ 9,000
Revenues	$390	$300	$4,000	$ 8,000
Expenditures/expenses	$350	$250	$3,800	$ 7,000

If a government considers a fund significant, perhaps because of the nature of the activity it covers, it can designate it as major. For example, a special revenue fund used to account for drug forfeiture assets in a police department may be widely discussed in the newspapers and should be transparent for the public to review.

3.5. *Connection between Government-Wide and Fund Statements*

Step 3 in the accounting cycle road map shown in table 3 mirrors what most state and local governments do; that is, they capture information in funds first and then make changes to that information, which is then presented in government-wide financial statements. Those changes reflect the following:

- Governmental funds use modified accrual accounting in accounting for governmental activities and therefore must be converted to full accrual accounting used at the government-wide level. Reconciliation schedules are prepared to show exactly why governmental fund balances are different from the governmental net position and why the changes in governmental fund balances are different from the changes in governmental net position.
- The internal service fund information (although a proprietary fund) is reported in the governmental activities column, rather than in the business-type activities column, if the services primarily benefit the government.

The disadvantage of this method is that government-wide statements are not available until the end of the period (usually the end of the year) when modified accrual-based governmental fund information is converted to full accrual-based information. Therefore, users don't benefit from the valuable perspective offered by government-wide statements until sometimes months after the fiscal year has ended.

An alternative strategy to the accounting cycle is to design the accounting information system to tag governmental activity transactions with two perspectives: a governmental fund perspective and a government-wide accrual basis perspective.[34] This dual track shows how a transaction is handled differently under each basis of accounting. The advantage of this system is that government entities can generate GASBS 34-compliant financial statements each month so the governing and oversight bodies (e.g., city council members) can review the big picture and budget each month to avoid surprises at the end of the year.

[34] This dual perspective is the approach taken by Reck, Lowensohn & Wilson (2016).

Consider the example of the dual perspective in table 8. A city council has approved the purchase of 10 police cars, each costing $50,000, to be used in the governmental program of Public Safety in its annual budget.

Table 8. Journal Entries for Acquisition of Capital Assets

	Debit	Credit
General Fund journal:		
Expenditures	$500,000	
Vouchers payable		$500,000
Governmental activities journal:		
Vehicles (a capital asset)	$500,000	
Vouchers payable		$500,000

Because the General Fund is a governmental fund designed to measure the current financial resources and report on the short-term compliance with the budget, the modified accrual basis of accounting records expenditures as the account to be charged so that it can be matched up with the appropriations (the legal authority from the budget to spend money) to see if there is any difference in what actually happened compared to what was expected. Alternatively, at the government-wide level, the full accrual basis of accounting directs us to capitalize, not expense, the acquisition of capital assets that will benefit more than one accounting period, and then depreciate those assets as they are used in providing government services.

A similar analysis can be done with the example of issuing general long-term debt (at par) to be used to build a government building as shown in table 9.

Table 9. Journal Entries for Long-Term Debt

	Debit	Credit
Capital projects fund journal:		
Cash	$1,000,000	
Proceeds of bonds		$1,000,000
Governmental activities journal:		
Cash	$1,000,000	
Bonds payable		$1,000,000

The capital projects fund is a governmental fund following a modified accrual basis of accounting, and it focuses on the short-term matching of the inflow of resources to what was budgeted. So the account name "proceeds of bonds" can be compared to the budget's estimate of revenues, and if they are the same, the fund has served its purpose. Alternatively, at the government-wide level, you want to see all the long-term debt on the statement of net position because the long-term capital assets that relate to it will be there, and, like a business, it is reported as a long-term liability until principal payments are made to reduce it.

The technical capacity to capture different attributes of transactions is available; whether governments have the will or ability to build such systems is an empirical question. When government-wide statements are valued as decision-making tools, the demand for such information on a regular, monthly basis should spur the investment in an improved accounting information system. The city of Flint, Michigan, provides a chart in the Management's Discussion and Analysis section of its CAFR to show the connections and differences between the components of the basic financial statements, government-wide and fund financial statements, as shown in table 10.

Table 10. Major Features of Government-Wide and Fund Financial Statements for the City of Flint, Michigan

Type of statements	Government-wide	Governmental funds	Proprietary funds	Fiduciary funds
Scope	Entire city government (except fiduciary funds) and the city's component units	The activities of the city that are not proprietary or fiduciary, such as police, fire, and parks	Activities the city operates similar to private businesses, such as the water and sewer system	Instances in which the city is the trustee or agent for someone else's resources, such as the retirement plan for city employees
Required financial statements	• Statement of net position • Statement of activities	• Balance sheet • Statement of revenues, expenditures, and changes in fund balances	• Statement of net position • Statement of revenues, expenses, and changes in fund net position • Statement of cash flows	• Statement of fiduciary net position • Statement of changes in fiduciary net position
Accounting basis and measurement focus	Accrual accounting and economics resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
Type of asset or liability information	All assets and liabilities, both financial and capital, short term and long term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets included	All assets and liabilities, both financial and capital, short term and long term	All assets and liabilities, both short term and long term, (the city's funds do not currently contain capital assets although they can)
Type of inflow or outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during the year, regardless of when cash is received or paid	All revenues and expenses during the year, regardless of when cash is received or paid

Source: Management's Discussion and Analysis, Comprehensive Annual Financial Report, FY 2013.

4. Michigan Governments in Fiscal Distress

As comprehensive as the GAAP government financial reporting model is, it is only useful if statements are accessed, understood, and used by decision makers. The financial statement supply chain, composed of financial managers, preparers, auditors, analysts, and regulators, have access to and do understand CAFRs and general purpose external financial statements. However, with so many states, local governments, public school systems, and public pension plans in the news because they are in fiscal distress, it appears that local governing bodies and taxpayers do not track the financial trends of their governments in time to react to signs of bad news. Rather than keeping up with financial statements, stakeholders may be relying on intermediaries such as municipal bond analysts or the media to be watchdogs over public funds and then to alert the taxpaying public when trouble arises.

Today's high-profile financial crises of governments challenge the traditional view that municipal bonds and public pensions are less risky than corporate bonds in terms of the assurance of meeting interest and principal obligations to holders of municipal bonds and pensions. There have been a few notable government failures previously in the United States (Joffe 2013). However, in the last decade more cities and public pension plans than ever have applied for bankruptcy protection,[35] some states have been unable to balance an annual budget,[36] and some public schools have consolidated and are outsourcing the delivery of educational services.[37] The recent Great Recession, resulting from downturns in housing, manufacturing, and financial markets in the United States, appeared to overwhelm some public entities. Many were just not nimble enough to downsize government operations when faced with a decrease in population, a reduction of assessed property values, mounting deferred maintenance on aging

[35] Local governments can seek relief from Chapter 9 of the federal bankruptcy code. Recent examples include the cities of Stockton, San Bernardino, Mammoth Lakes, and Vallejo in California. The unfunded pension liabilities of cities such as San Diego, Atlanta, Baltimore, Chicago, Cincinnati, Philadelphia, and Providence threaten the financial solvency of these cities (Associated Press, Jan. 3, 2013).
[36] The National Conference of State Legislatures reports that 36 of 50 states have stringent balanced budget requirements; however, only 22 states have enforcement provisions. They report that the most likely predictor of whether a state budget will be balanced is the tradition of balancing budgets. (National Conference of State Legislatures October 2010).
[37] For example, see Smith (2014) about the end of the Mosaica Education contract in Michigan.

infrastructure, and increases in employee and retiree healthcare and pension costs. Long-term contracts with employee unions, pension plans, and vendors are difficult to renegotiate in the middle of a contract period.

In this section, we look at Michigan cities and public schools that are in fiscal distress to find ways that decision makers could have used financial statement trends to make better short- and long-term decisions. Michigan is of interest because of its historical dependence on one industry (automotive), its strong tradition of a unionized public sector work force, and as the state in which the largest municipal bankruptcy was recently completed. In addition, the state of Michigan makes financial statement data related to state and local governmental units readily available to the public on its website.

4.1. *Michigan's Local Government Monitoring*

All states have a fiduciary responsibility to step in when their local governments are in fiscal distress, given that states granted legal existence to local governments. Michigan has had a law in place since 1968 that requires local government units that have a "deficit condition" to formulate a deficit elimination plan.[38] A deficit condition exists for governmental funds if the total of the committed, assigned, and unassigned fund balance is negative. Stated another way, there is a deficit condition if the sum of the nonspendable and restricted governmental fund balances exceeds the total governmental fund balance. Table 11 shows an excerpt from the fund balance section of the most recent governmental funds balance sheet for the city of Detroit.

[38] Michigan Public Act 2 of 1968, The Uniform Budgeting and Accounting Act, MCL § 141.438(3) states that "the local unit shall not incur expenditures against an appropriation in excess of the amount appropriated by the legislative body."

Table 11. City of Detroit's Governmental Funds Balance Sheet for FY 2013

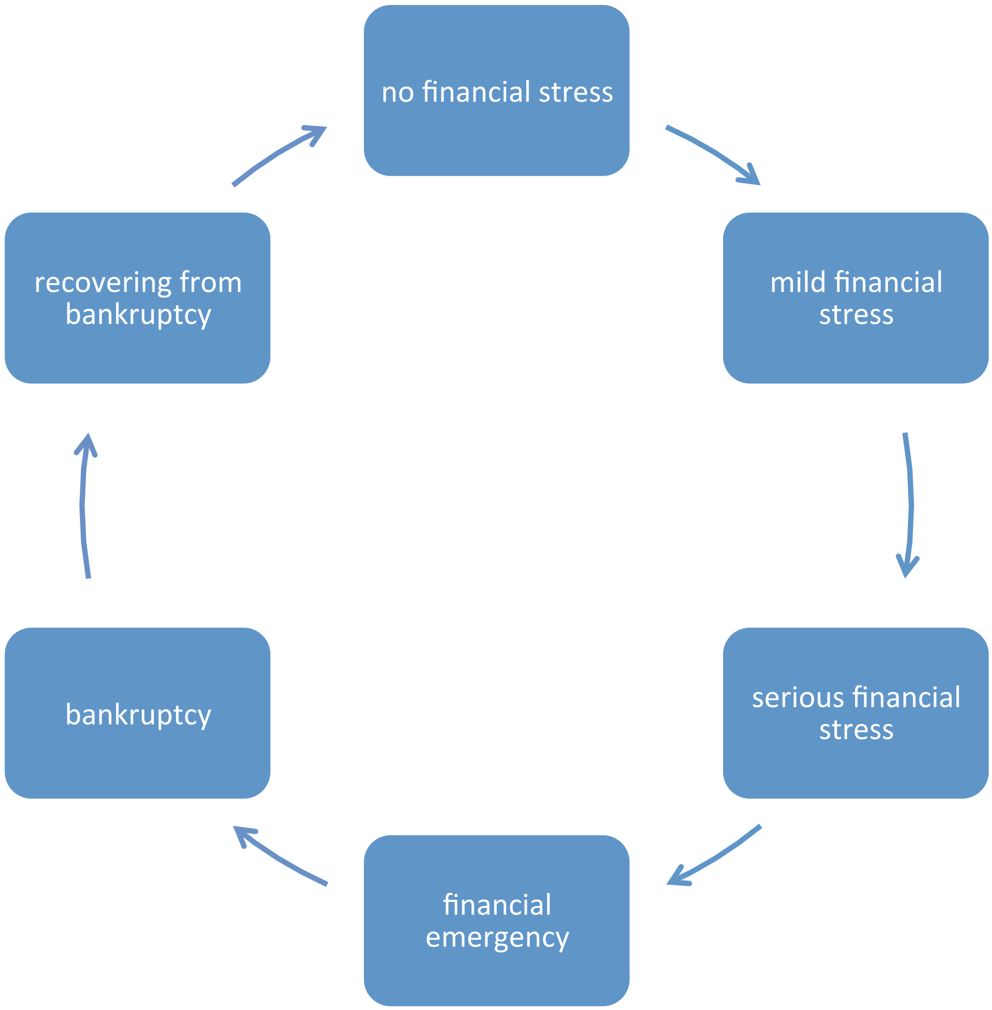
Fund balances (deficit)	General Fund (GF)	General Retirement System Service Corporation	Other governmental funds	Total
Nonspendable*	$4,050,006	$24,016,604	$937,861	$29,004,471
Restricted for various**	979,826		149,629,036	150,608,862
Committed for risk management operations	54,550,314			54,550,314
Assigned for debt service			7,899,702	7,899,702
Unassigned GF (deficit)	(132,560,895)			(132,560,895)
Total fund Balances (deficit)	($72,980,749)	$24,016,604	$158,466,599	$109,502,454)

Source: http://www.detroitmi.gov, How-Do-I, view City of Detroit reports, City of Detroit CAFR.
* Nonspendable amounts are for long-term receivables and permanent fund principal. Spendable amounts are classified into four categories—restricted, committed, assigned, and unassigned—although it is customary not to use the header "spendable."
** Restricted amounts are for highway and street improvements, police, endowments and trusts, capital acquisitions, local business growth, rubbish collection and disposal, grants, and public lighting.

As can be calculated from the total column on the right, the sum of committed, assigned, and unassigned fund balances is a negative $70,110,879, so the city is in a deficit condition. The sum of nonspendable and restricted fund balances is $179,613,333, which is greater than the total fund balance of negative $109,502,454, the alternative way to see that the city is in a deficit condition.

Figure 2 shows a cycle of financial condition levels that a government may go through, from no financial or fiscal stress to recovering from bankruptcy. As just described, the state of Michigan considers a governmental fund deficit condition an early warning sign of mild financial stress and steps in to require a deficit elimination plan.

Figure 2. Financial Condition Levels of a Government



Michigan's oversight of distressed localities is more centralized than in other states (Holeywell 2012). Public Act (PA) 72 of 1990, The Local Government Fiscal Responsibility Act, authorizes the state to intervene in governmental units that experience financial emergencies. If a local government unit is in serious financial stress, the state may conduct a review or create a consent agreement with remedial measures, such as a continuing operation or recovery plan. If the state determines that the local government is at the financial emergency level, it will either appoint an emergency financial manager or put the unit under receiverships with a transition advisory board. This process may lead to bankruptcy being filed under section 9 of the federal statute.[39]

As shown in table 12, at the time of this study 17 government units (11 cities, 1 township, and 5 public school districts) were in serious financial stress and under various levels of state control, including state review, consent agreement, receivership, and emergency financial manager, or were in bankruptcy proceedings. The table notes the county in which the government is situated, because that is how data are accessed at the state's website. The table also provides the size of the government as measured by its current population and the date it entered this stage of state control. Detailed financial and demographic information for the general-purpose governments (i.e., cities and townships) is provided in panels in the appendix, as noted in the first column of table 12. Public schools in fiscal distress are not detailed in the appendix because they are different from cities and townships in that they have a special purpose—delivering education—rather than a general purpose—providing a wide range of public services.

For the Chartered Township of Royal Oak, one of the governments listed in table 12, the Audit Report for the fiscal year 2013 includes this paragraph:

> On April 21, 2014 the Township entered into a Consent Agreement with State Treasurer, R. Kevin Clinton, a Michigan state officer ("State Treasurer"). The State of Michigan determined that a financial emergency exists within the Township under the Local Financial Stability and Choice Act, 2012 PA 436, MCL 141.1541 to MCL 141.1575 ("ACT 436"). To address the financial emergency, The Township has selected the consent agreement option section 8 of Act 436, where the State Treasurer offers state financial management and technical assistance as necessary to alleviate the financial emergency. Our opinion is not modified with respect to this matter.

[39] Adapted from the State of Michigan, Department of Treasury, Local Government Services, Local Government Fiscal Health, Office of Fiscal Responsibility, see www.michigan.gov/treasury.

Table 12. Michigan Governmental Units in Fiscal Distress

Panel in appendix	Level of fiscal distress	County	Population of the city[a]	Date state control began[b]
	In Chapter 9 bankruptcy and under emergency manager			
A	City of Detroit	Wayne	713,777	Jul 2012[c]
	Under emergency manager			
B	City of Allen Park	Wayne	34,196	Oct 2012
C	City of Flint	Genesee	99,763	Nov 2011
D	City of Hamtramck	Wayne	21,300	Jun 2013
E	City of Lincoln Park	Wayne	45,105	Jul 2014
	Detroit Public Schools	Wayne	688,701	Mar 2009
	Highland Park School District	Wayne	27,909	Jan 2012
	Muskegon Heights School District	Muskegon	40,823	Mar 2009
	Under receivership with transition advisory board			
F	City of Benton Harbor	Berrien	10,038	Mar 2010
G	City of Ecorse	Wayne	9,341	Oct 2009
H	City of Pontiac	Oakland	76,715	Mar 2009
	Under consent agreement			
I	City of Inkster	Wayne	35,190	Feb 2012
J	City of River Rouge	Wayne	7,762	Oct 2009
	Pontiac Public Schools	Oakland	76,715	Sep 2013
K	Charter Township of Royal Oak	Oakland	2,445	Apr 2014
	Under review or preliminary review			
L	City of Highland Park	Wayne	27,909	Dec 2013
	Benton Harbor Area Schools	Berrien	10,038	Apr 2014

(a) Population numbers from 2013 estimates, US Census Bureau (http://factfinder2.censusgov). Population for a school district is reported as the same population as the primary city.
(b) Date at which the governmental unit went into that stage of fiscal distress from http://www.michigan.gov /treasury, Local Government Services, Local Government Fiscal Health.
(c) Detroit exited bankruptcy in December 2014.

Michigan's local governments in fiscal distress are of interest nationwide. Detroit is the largest city in the United States to navigate the federal bankruptcy process (Foroohar 2013), not only in terms of debt, population affected, and number of creditors, but also in terms of legal and professional fees (Halcom 2014). The cities of Flint and Highland Park are "company towns" built around a single company in the automotive industry.[40] Some school districts avoided state control by making tough decisions—the Buena Vista School District in Saginaw County merged with the Saginaw Public School District; Willow Run School District in Washtenaw County merged with Ypsilanti School District; and Albion High School in Calhoun County closed (Carmody 2013).

Michigan's recent legislative history related to state intervention in local governments' fiscal affairs may also have interest nationwide. The Michigan legislature repealed PA 72 of 1990 and enacted PA 4 of 2011, the Local Government and School District Fiscal Accountability Act, which allows the state to intervene at an even earlier stage in order to avoid the need for an emergency financial manager. The law included authority to renegotiate union contracts because employee wages and benefits are the largest expenditure for most governments. Many citizens and groups did not like the expanded state powers in this law. Because the authority of PA 4 of 2011 was so widely challenged, it was placed on a statewide ballot in the November 2012 election as Proposal 1. It was defeated by voters 52 percent to 48 percent, so the law did not go into effect. However, just five weeks later during the December 2012 lame duck session, the Michigan legislature passed a new law: PA 436 of 2012, the Local Financial Stability and Choice Act. This legislation gave the state the power it needs to step in to resolve a local financial crisis, but compromised by allowing voters to choose among four approaches: consent agreement, mediation, emergency manager, or Chapter 9 bankruptcy. The bill included a spending appropriation provision, which means it cannot be challenged by voters at the ballot box.

Criticism by the public of the state's actions continued. Davey explains that "critics have said that the state's intervention is an undemocratic seizure of power" (*New York Times*, March

[40] Highland Park was the site of Ford Motor Company's first assembly line to build Model Ts in the 1920s. General Motors had a Buick plant in Flint from 1904 until 1999, which drew many auto suppliers to the area.

14, 2013). Some voters feel their constitutionally protected right to vote for representation has been taken away from them when a governor appoints an emergency financial manager with the power to break contracts that have been agreed to by elected city council members and to sell off assets of the city. The NAACP filed a lawsuit in 2013 challenging the emergency manager process.[41] Often cities hit hardest by an economic downturn are home to citizens with lower than the national average of income and education levels.

Current law (PA 436 of 2012) sets out the following conditions that will trigger a preliminary review:

- A creditor's claim greater than $10,000 is six months overdue.
- A specified number of voting residents allege local government financial distress.
- Minimum obligations to the government pension fund are not made.
- Wages and salaries or other compensation owed to employees or benefits owed to retirees are more than seven days overdue.
- The government defaults on a bond or note payment or covenant.
- The government is delinquent in distributing tax revenues to other taxing jurisdictions.
- Obligations under a deficit elimination plan are breached.
- A court orders an additional tax levy without the prior approval of the government.
- A long-term debt rating below the Better Business Bureau category is received.

Other signs of fiscal distress not specifically listed as triggers in the law include the following:

- closing large facilities that are a big part of the tax base
- large chargebacks to the county from the city

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[41] Associated Press. 2013. Lawsuit Next Week to Challenge Emergency Manager Law." *Detroit Free Press*, May 10. Accessed at www.freep.com/article/20130510/NEWS01/305100106/emergency-law-kevyn-orr.

- tax levies at the maximum millage rate
- more retirees than active workers
- rising long-term debt obligations
- sharp decreases in property taxable values
- large General Fund budgets
- aging infrastructure
- declining population[42]

In a 2002 study on fiscal distress indicators conducted by the Institute for Public Policy and Social Research at Michigan State University for the Michigan Department of Treasury, researchers suggested that, in addition to the government's CAFR, data for indicators can come from the Michigan Municipal League, the US Census Bureau, and the US Department of Labor (Kleine, Kloha & Weissert 2002, 2003). Their list of indicators includes the following:

- population growth
- real taxable value growth
- large real taxable value decrease
- General Fund expenditures as a percent of taxable value
- General Fund operating deficit
- prior General Fund operating deficits
- size of General Fund balance
- fund deficits in current or previous year
- general long-term debt as a percent of taxable value

[42] Office of Fiscal Responsibility, Local Government Services, Department of Treasury, State of Michigan at www.michigan.gov/treasury.

- local unit millage rates
- revenues per capita and expenditures per capita
- debt service expenditures

For this study, we have chosen 15 indicators to present in the panels in the appendix. The indicators we chose capture some of the above stress signals as well as other indicators discussed in government financial performance literature (Chaney, Mead, & Schermann 2002). In the appendix, we review these indicators for the 12 general-purpose governments (i.e., cities and townships) but not for the special-purpose governmental units (i.e., public school systems). For each of these, we have collected data from three years: fiscal year (FY) 2004, one of the first years data was made available on Michigan's database of audited annual reports for local governments;[43] FY 2013, the most recent year available for this report; and FY 2008, approximately halfway between those two years.

There are many indicators that a governing body could track to get an early warning about a fiscal crisis, such as unemployment rate, assessed valuation of property (the basis for tax revenue), percentage of people living in poverty, and education levels. We have chosen a relatively small list of financial indicators that are readily available in the Comprehensive Annual Financial Report or general-purpose external financial statements (if a CAFR is not prepared). We have organized these indicators into five categories according to where they will be found: (1) government-wide financial statements, (2) fund statements, (3) notes and required supplementary information, (4) the statistical section of the CAFR, and (5) the Audit Report. Data from the 12 Michigan governments listed in table 13 are provided in panels in the

[43] See www.michigan.gov/treasury/0,4679,7-121-1751_31038---,00.html for a list of Michigan governments. Each governmental unit in Michigan is required to submit an audited financial report once a year, unless it has a population of less than 4,000, in which case the requirement is to submit a report every other year.

appendix to illustrate each indicator. The far right column shows the recent trend as measured from the FY 2008 to FY 2013. Indicators are just that, an indication of a trend that should be further investigated by talking with government finance officers. A positive or favorable label (+) is given to indicators that move toward more assets or revenue and less debt and obligations. A negative or unfavorable label (−) is given when the trend will likely lead to more fiscal distress. The usefulness of each indicator is first described, followed by a summary of the trends in that indicator from FY 2008 to FY 2013 for the set of 12 fiscally distressed Michigan governments.

4.2. *Indicators from Government-Wide Statements*

This section describes five indicators from the government-wide statements. Information from these two accrual-based statements, available for about the last 15 years, offers a view of the big picture of the government's net position (previously called net assets) and the change in that position between two fiscal years. The indicators presented next capture the government's ability to pay current liabilities due within the next 12 months as well as longer-term obligations for debt and benefits promised to retirees. Tracking governmental activities over time allows sitting council or board members to monitor the performance of appointed managers and assess the effectiveness of policy decisions and commitments made by prior councils or boards. Tracking business-type activities, such as operating public utilities and golf courses, allows analysis of the profitability of entrepreneurial activities that can be used to support the primary public purpose of the government.

4.2.1. Unrestricted net position—governmental activities. The statement of net position at the government-wide level reports the difference between assets and liabilities for governmental activities as net position. The portion of net position that is available for future expenses is labeled "unrestricted." This number is not the same as cash because cash is just one type of asset that makes up the net position. A negative net position is labeled a "deficit." Although the governing body and management may focus on the General Fund's unassigned fund balance as the "rainy day fund," unrestricted net position may be a better measure because it is derived using accrual accounting and encompasses the government as a whole.

All 12 of the Michigan governments in fiscal distress have a negative trend in this indicator; that is, the level of unrestricted net position is lower in FY 2013 than it was in FY 2008. Eight of these governments increased an existing deficit. Of most concern would be the four governments that went from a positive unrestricted net position to a deficit: Allen Park (panel B), Hamtramck (panel D), Lincoln Park (panel E) and Royal Oak (panel K).

4.2.2. Change in net position—governmental activities. If actual revenues exceed actual expenses for governmental activities in a year, then that difference will have a positive impact on the cumulative net position—governmental activities reported on the statement of net position. If expenses exceed revenues for the year, then that deficit will decrease the total net position. The statement of activities at the government-wide level reports on the change in total net position for *all* governmental activities; it does not show the breakdown for unrestricted governmental activities.

Seven of the twelve Michigan governments in fiscal distress had a negative trend in this indicator as seen in the panels in the appendix. Most of these cities had an even greater decrease in net position in FY 2013 than in FY 2008. Hamtramck (panel D) and River Rouge (panel J) went from a positive change in net position in FY 2008 to a negative change in FY 2013. Of less concern is Pontiac (panel H), which has a smaller, but still positive, increase in net position from five years ago. Benton Harbor (panel F) continued to decrease its net position in FY 2013, but at a lower level than in FY 2008 so it is labeled a positive trend.

4.2.3. Working capital ratio—governmental activities. An indicator of whether an entity is liquid and can pay its current liabilities as they become due is the extent to which current assets (e.g., cash, accounts receivable, inventory, prepaid expenses, internal balances,[44] current portion of long-term debt) exceed current liabilities (e.g., accounts payable, accrued expenses). Current refers to the next 12 months. Current assets less current liabilities is called working capital, and the ratio of current assets to current liabilities is called the current or working capital ratio. A rule of thumb is that the entity should have at least twice as much in current assets as it does current liabilities; however, ideal ratios differ by industry and type of entity. Working capital ratios should be at least 1:1, and even that may be too close for comfort considering that some current assets (e.g., inventory and prepaid rent/insurance/advertising) will never be available to pay for current liabilities and sometimes accounts receivable may be old and uncollectible. A liquidity problem will cause governments to be in a fiscal crisis, leading auditors to question whether it is sustainable as a "going concern."

Six of the 12 distressed Michigan governments show a decrease in working capital ratio from FY 2008 to FY 2013. Three cities to watch carefully, though, are Detroit (panel A), Benton Harbor (panel F), and Inkster (panel I), which show negative trends and all have FY 2013 ratios

[44] Internal balances are the net amount of receivables and payables between governmental activities and business-type activities. In this paper, they are classified as current assets, although the net amount could be a negative number.

that are less than 1:1. Three other cities (i.e., Allen Park [panel B], Pontiac [panel H], and River Rouge [panel J]) have working capital ratios that are under 2:1.

4.2.4. Non-current liabilities—governmental activities. The advantage of using accrual accounting at the government-wide level over modified accrual accounting at the fund level is that the long-term debt (non-current liabilities) incurred to acquire capital assets and those capital assets for the government as a whole are both readily visible in the statement of net position. General long-term debt is usually borrowing in the form of general obligation or municipal bonds,[45] but also includes unearned revenue, pensions, and other postemployment benefits (OPEB). Taxpayers have an opportunity to approve new bond issues or renewals by agreeing to property tax increases to "service" the debt in the future; however, other non-current obligations are approved by city councils or boards as they approve annual budgets brought forth by mayors and city managers. Taxpayers can attend open budget meetings but they don't vote on employee or union contracts.

For 11 of the 12 distressed Michigan governments we see a negative trend—that is, an increased amount of general long-term debt from FY 2008 to FY 2013. Allen Park (panel B) has almost five times as much debt in FY 2013 as five years earlier, Flint (panel C) has almost doubled its long-term debt in that period, Lincoln Park (panel E) did double its debt, and Benton Harbor (panel F) has almost three times as much debt in FY 2013. These large increases may be due in part to the reporting of OPEB required by GASBS 45 in 2008.[46] Inkster (panel I),

[45] General obligation bonds are backed by the full faith and credit of the government, rather than collateralized by a dedicated revenue stream as happens in an enterprise fund activity (e.g., an airport, golf course, or utility plant).
[46] Implementation of GASBS 45 was in three phases depending on the size of the government. Some of these twelve Michigan governments did not likely report on OPEB in the FY 2008 CAFR.

although a negative trend, stands out in a good way because it only increasing its long-term debt by 2 percent.

4.2.5. Unrestricted net position—business-type activities. Governments engage in business-type activities when they think they can generate a profit or when there is a service they can offer that is difficult for the public to get on its own. In the second case, the government will operate the activity in a business-like manner in order to track whether it is profitable or whether the General Fund is subsidizing the activity. Examples of business-type activities are water and sewer treatment facilities, airports, hospitals, parking garages, municipal golf courses, and pools. The unrestricted net position of the business-type activity reported on the government-wide statement of net position is a good indicator of whether the activity has been more or less profitable over all the years of its existence. Unrestricted net position can be thought of as retained earnings for a business. If the unrestricted net position is negative, it is labeled a "deficit."

Nine of the twelve distressed Michigan governments have a negative trend in the unrestricted net position of their business-type activities between FY 2008 and FY 2013. Detroit (panel A) and Allen Park (panel B) changed from positive to negative net positions in that time period. Highland Park (panel L) now has a deficit that is almost three times greater than the deficit in FY 2008. More investigation into these business-type activities is required to determine whether some activities are discretionary and can be discontinued if they continue to be unprofitable or if the activities relate to utilities that involve other governments, in which case cost efficiencies must be found in order to move the activity into a positive, unrestricted net position.

4.3. *Indicators From Governmental Fund Statements*

Traditional governmental fund statements focus on the short-term, one-year budget. Of all the governmental funds, the General Fund is the one that captures the primary day-to-day functions of the government, such as public safety, courts, parks, health, and welfare. Zeroing in on the "unassigned fund balance" and how it changed over the year allows a quick assessment of the current manager's and board's performance in working within the legally authorized budget.

4.3.1. Unassigned General Fund (GF) fund balance. The Balance Sheet for the General Fund shows the level or balance in all asset, liability, and fund balance accounts as of the last day of the fiscal year. Attention is often paid to the unassigned fund balance as a "rainy day fund"—that is, an amount available to be appropriated for future years' expenditures. Before GASBS 54 (2009), this account was called unreserved fund balance. Using current GAAP categories to describe fund balance, it is the difference between assets and liabilities that can be spent in future years that is neither restricted, nor committed, nor assigned for any other purpose. It is important to check the cash balance before concluding that you can spend any unassigned fund balance. Assets other than cash, such as accounts receivable, inventory, and other current assets, will make the available checkbook cash balance smaller than the unassigned fund balance.

Best budgeting practices suggest that governing bodies should have a policy on what level this "rainy day fund" should be. For example, a city with a $1,000,000 expenditures budget may prescribe that the General Fund unassigned fund balance be 25 percent of annual expenditures, or $250,000. One-fourth of a year or three months' worth of expenditures may not seem like a large rainy day fund, but there will be tension to manage between taxpayers' reluctance to be taxed currently for future expenditures and management's desire to have a cushion for unexpected expenditures that may arise. A negative fund balance is labeled a deficit. Trussel and Patrick (2009, 580) label a government “fiscally distressed” if it has annual operating deficits in three consecutive years. We report on the General Fund only and not on the other governmental funds (i.e., special revenue funds, capital projects funds, debt service funds, and permanent funds), although there are indicators in these funds that a government may want to track.

One-half of the twelve Michigan governments in some fiscal distress showed a decrease in the unassigned General Fund fund balance from FY 2008 to FY 2013. Of these six, Allen Park (panel B), Lincoln Park (panel E), and Inkster (Panel I) went from a positive General Fund fund balance to a negative one. Flint (panel C) increased its negative General Fund fund balance, and River Rouge (panel J) and Royal Oak (panel K) decreased a positive General Fund fund balance to a smaller positive number.

4.3.2. Change in General Fund fund balance. The statement of revenues, expenditures, and changes in fund balance for the governmental funds shows how the General Fund and all other major and nonmajor fund balances have changed over the fiscal year. This operating statement does not delineate the changes in each classification of fund balance, for example, in unassigned fund balance. The term “deficit” is used in two ways—when the *annual* expenditures exceed annual revenues for the year and when the *accumulation* of expenses over time reported on the balance sheet is greater than the accumulation of revenues over time.

Only four of the twelve governments in fiscal distress had negative changes in the amount by which the General Fund fund balance changed between FY 2008 and FY 2013. Presumably Michigan’s monitoring of governments in fiscal distress helped to bring current spending into line with current revenues. Allen Park (panel B) saw a positive difference in FY 2008 change to a smaller positive difference in FY 2013. Lincoln Park (panel E), Royal Oak (panel K), and Highland Park (panel L) went from a positive difference between revenues and expenditures in FY 2008 to a decrease five years later.

4.4. *Indicators from Notes to the Financial Statements and Other RSI*

The notes that follow the basic financial statements are integral to understanding those statements, as they contain narrative and quantitative context. Notes are identified by number and topic. Other required and supplementary information follow the notes. The long-term debt note is an example of a part that contains very detailed calculations of interest expense and liability for each category of debt that may be of most interest to bond analysts, insurers, and underwriters, as well as the single measure called “bond rating.” Some governments report the bond rating in this note to the financial statements. Each of the municipal bond rating agencies (i.e., Moody’s, Standard & Poor’s, Fitch Ratings) assigns a rating (e.g., A, AA, B) that embodies an assessment of the financial strength of the government and its ability to meet its debt obligations. Governing bodies can track changes in these ratings over time and investigate the signals that the rating agencies indicate affected their change in rating. In this study, we select three indicators other than bond ratings from the notes or required supplementary information that are useful for governing bodies to track over time.

4.4.1. Pension plan funded ratio. Pension plans require contributions to be made and invested that are sufficient to cover the predicted cost of delivering benefits to retirees over their lifetimes. Governing boards may require funds to be set aside at a certain rate to meet this obligation. Other governments may pay as they go; that is, cash is paid out as retirees collect pensions and no additional amount is set aside for future payments. GAAP accounting for pension plans is complicated, but it is designed to properly measure the value of invested pension assets, pension liabilities, and pension expenses. The GASB as an accounting standards-setter has no authority to compel a certain funded ratio. A ratio that is tracked and reported in the notes to the financial statements is the funded ratio—that is, the percentage that the actuarial value of pension assets is to the actuarial accrued liability. Pension plans can be 100 percent funded or more or less than that amount. Governments with a relatively low funded ratio will find it difficult to meet their obligations as they become due. Many governments have two or more pension plans, usually one for general employees and one for police and fire employees.

Eight of the twelve governments in fiscal distress show smaller funded ratios in FY 2013 than in FY 2008. River Rouge (panel J) is showing a positive, but almost identical, ratio between FY 2008 and FY 2013. Highland Park (panel L) shows a large positive change in the pension funded ratio. Arguably, percentages in the 80–90 percent range are high and yet any number less than 100 percent indicates the possibility that the government could not meet its pension obligations as they become due. Inkster (panel I) and Royal Oak (panel K) do not report on funded ratio clearly in the notes to the FY 2008 financial statements.

4.4.2. Other postemployment benefits. The GASB issued its requirement to record the expense and liability for promises to pay retirees health and life insurance for life in 2004, but the smallest governments did not have to implement this standard until 2008 or 2009.[47] As most of

[47] GASB Cod. Sec. P50 Postemployment Benefits Other Than Pensions.

the governments shown in the appendix are small, information about the OPEB liability appears only in FY 2013. The OPEB liability may also be listed as a separate line item on the statement of net position.

Only Detroit (panel A) shows OPEB information in its notes in both FY 2008 and FY 2013. Its long-term liability for health care expenses for retirees is more than five times greater in FY 2013 than five years earlier. In all the other governments, the OPEB amount in FY 2013 is a relatively high number compared to long-term liabilities Recognizing the difficulty in meeting these promises, most governments have made changes to their health care promises for current employees when they retire as businesses did in the 1990s when FASB required reporting the expense and liability for the present value of the promise to pay retirees' health care for life.[48]

4.4.3. General Fund expenditures/appropriations. A comparison of the approved General Fund budget with actual revenues and expenditures for a fiscal year has been a part of the government financial reporting model since the 1930s. Under current GAAP, a government can present this information within the basic financial statements (i.e., before the notes to the financial statements) or as a schedule that follows the notes. In either case, it is required with columns for the original and final approved budget. It is not likely that actual expenditures will be 100 percent of the amount appropriated for spending; however, that is the intent when councils or boards appropriate money according to a budget. It is informative to calculate whether the government actually spent more than was budgeted (i.e., bad news) or less than was budgeted (i.e., good news). Spending less than the budget may not actually be good news, but rather a cost-saving strategy that leads to essential services not being offered. Monthly monitoring by

[48] FASB ASC Topic 715-60 Compensation-Retirement Benefits: Defined Benefit Plans– Other Postretirement.

governing bodies of the movement of this ratio closer to 1:1 allows time for adjustment from spending too much to not enough.

Seven of the twelve governments in fiscal distress have a negative trend in this ratio; that is, the ratio of expenditures to appropriations moves away from 1:1. Detroit stands out with the lowest cost ratio of 56 percent, indicating that bankruptcy proceedings likely led to greater cost-cutting measures than anticipated in the budget. Inkster (panel I) and Royal Oak (panel K) have ratios greater than 1, indicating that they are spending more than the legal appropriation. Lincoln Park (panel E) and Pontiac (panel H) positively moved to ratios of 1:1 in FY 2013.

4.5. *Indicators from the Statistical Section of the CAFR*

Only the largest two of the twelve distressed Michigan governments (Detroit and Flint) prepared a CAFR. A CAFR is not required to be in conformance with GAAP; however, if one is prepared, the Statistical section of the CAFR should contain parts that report on financial trends, revenue capacity trends, debt capacity trends, demographic and economic trends, and operating trends over a 10-year period.[49] Monitoring these trends can provide valuable information in detecting signs of fiscal distress.

4.5.1. Debt margin. Debt margin is the difference between the authorized debt limit and outstanding long-term debt that applies to that limit in dollars; that is, the unused debt limitation. A margin is a comfort zone indicating that the government has the capacity to borrow more funds if needed. The Michigan constitution allows municipalities to incur debt for public purposes, but the Home Rule Act (PA 279) of 1909, as amended, sets a debt limit as a percentage

[49] GASB Codification Sec. 2800, Statistical Section.

of assessed value of real and personal property. Also reported in this study is the percentage of outstanding debt to the debt limit, which is just another way to view the remaining capacity of the government to borrow. A negative trend is indicated by a lower debt margin in dollars and a higher ratio of outstanding debt to debt limit.

Both Detroit (panel A) and Flint (panel C) have a negative trend in the debt margin indicator, as seen by the amount of debt limit decrease and the percentage of outstanding debt to the debt limit increase. Flint, however, is in a much better position because its debt limit is only 16.58 percent, meaning that it has a large margin between that percentage and 100 percent of what it may borrow.

4.5.2. Number of employees (full-time equivalent). A city in fiscal distress is expected to decrease its operating expenses in the face of declining revenues. Personnel costs make up the majority of a local government's operating expenses. We have coded a decrease in the number of full-time equivalent employees as a positive reaction to being in fiscal distress.

Both Detroit (panel A) and Flint (panel C) dramatically decreased their workforce in the last five years. We see a decrease of 35 percent for Detroit, to 8,912, and 53 percent for Flint, to 546. Although decreasing staff may be strategic, there could be additional costs that follow. For example, when "essential" police and fire staff are laid off, crime and safety issues may increase. Management may not be able to change union contracts with different employee groups without difficult negotiations. Some employee reductions come from outsourcing or privatizing public services, such as educational services in a public school, which shift salary costs to independent contractor expenses that may save in payroll taxes and benefits.

4.5.3. Population (from last US census or projected for 2013). Population figures can be obtained from Census Bureau reports online; however, it is convenient when a government includes this demographic information in its CAFR's statistical section. Trends over a 10-year period often use the official number from each 10-year cycle, which is not as helpful as using estimated annual numbers.

Detroit (panel A) shows a 25 percent decrease in population from FY 2008, to 713,777 in FY 2013. These numbers are actually from the 2000 and 2010 censuses. Flint (panel C) shows a 12 percent decrease from FY 2008, to 99,763 in FY 2013, using annual estimates. In both cases, if this negative trend persists, it is a warning that the cities should decrease the size of their governments as the property, sales, and income tax-paying base decreases, or they should seek alternative sources of revenue. We see decreases of employees accompanying decreases in population in both cities.

4.6. *Indicators from the Audit Report*

The product of an external audit by an independent certified public accountant is called an Audit Report. This report is found in the financial section of the CAFR before the general-purpose external financial statements. The AICPA prescribes the language of the report in the Statements of Auditing Standards. A government's standard report will have a scope paragraph indicating which statements were audited, a paragraph on management's responsibility for the statements, another on the independent auditors' responsibility, an opinion paragraph, perhaps others to emphasize other matters, and often paragraphs on other reporting, such as Single Audits related to the expending of federal financial assistance.

4.6.1. Audit opinion. The best opinion to receive from a CPA as a result of an audit is an "unqualified audit opinion," sometimes referred to as a "clean opinion." In such an opinion, the CPA attests that the financial statements (1) fairly present the financial position and results of operations for the time period audited and (2) conform to accounting principles generally accepted in the United States of America. If management has departed from GAAP, the auditor will "qualify" the opinion using the phrase "except for." If there is a serious departure from GAAP, the auditor may issue an "adverse" opinion. Finally, if the financial records cannot be audited, either because they are incomplete or because the accounting system has serious breaches of internal control so that sufficient audit evidence could not be obtained, the auditors will "disclaim" an opinion on the statements. Continuing to receive an unqualified audit opinion is labeled as a positive trend.

For 11 of the 12 Michigan governments in fiscal distress, we see a positive trend in the audit opinion indicator. Six of these governments received an unqualified audit opinion in both FY 2008 and FY 2013. Five governments moved to an unqualified audit opinion from one of the other options. The city of Benton Harbor (panel F) is the only government to show a negative trend; that is, it received a qualified audit opinion both in FY 2008 and in FY 2013. In the audit opinion for Benton Harbor's FY 2013 statements, the auditors explain their qualification in the Basis for Modified Opinions paragraph:

> The City has recorded general infrastructure assets only for projects that occurred subsequent to June 30, 2002. Accounting principles generally accepted in the United States of America require the reporting of general infrastructure assets for projects dating back to January 1, 1980. . . . The financial statements do not include financial data for the City's legally separate component unit, the Benton Harbor Cemetery Board. Accounting principles generally accepted in the United States of America require the financial data for all component units to be reported with the financial data of the City's primary government unless the City also issues financial statements for the financial reporting entity that include the financial data for all of its component units.

The auditors then provide this opinion:

> In our opinion, based on our audit and the reports of other auditors, except for the effects of the matters described in the Basis for Modified Opinions paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities . . . in conformity with accounting principles generally accepted in the United States of America.

4.6.2. Going concern comment. GAAP include the assumption that the entity is a "going concern"—that is, it is a sustainable entity for the foreseeable future. The going concern indicator is coded Yes if there is a comment or paragraph in the Audit Report on the sustainability of the entity as a going concern, accumulated operating deficits, or state oversight in some form. *Not* having a going concern comment is considered positive.

Highland Park (panel L) received a going concern comment in all three Audit Reports—FY 2004, FY 2008, and FY 2013—showing persistent signs of fiscal distress:

> **FY 2004 Going Concern/Management Plans.**
> Considering the extent of the government's fund deficits and its potential inability to satisfy future obligations when due, there is substantial doubt regarding the City's ability to continue as a going concern. The EFM (emergency financial manager) continues to work with the State of Michigan, creditors, other governmental units and financial institutions to address the City's financial problems and to determine the next appropriate course of action.
>
> **FY 2008 Note 16—Going Concern/Management's Plans**
> In June 2001, the State of Michigan Department of Treasury (the "State") appointed an Emergency Financial Manager (EFM) to run the City in accordance with Section 12(1) of Public Act 72 of 1990. The EFM was charged with the responsibility of balancing the annual operating budget and eliminating the cumulative General Fund deficit that totaled approximately $11,275,000 at June 30, 2001. In addition to the General Fund deficit and many other financial and operating matters, the EFM also had to address the repayment of the Water and Sewer Fund borrowing of approximately $4,900,000 from the General Fund. . . . The EFM submitted a detailed plan on how he was going to eliminate all deficits and address all other operating matters. In addition, the EFM submits an annual deficit elimination plan to the State detailing the action plan for all funds in a deficit. The General Fund at June 30, 2008 did not have a cumulative deficit. The General Fund had a fund balance of $3,075,801 but did have an unreserved, undesignated deficit of $1,970,087 due to the inability of the Water and Sewer Fund to repay its interfund borrowings of $3,553,126 (balance remaining from the 2001 amount noted above).

FY 2013 Note 16 Going Concern

In July 2009, the State removed the interim emergency financial manager from the City and returned control of the City back to the mayor and City Council. The City continues under State control per Public Act 436 at June 30, 2013. The mayor and City Council have submitted a revised deficit elimination plan detailing how the City plans to address the water and sewer deficit as well as other operating matters. The City is exploring alternative water service delivery methods and long-term solutions for its water plant. Currently, water and sewage services are being provided by the City of Detroit. In the current fiscal year, the General Fund transferred $771,279 to the Water and Sewer Fund to help cover operational shortfalls. The Water and Sewer Fund continued to have a significant operating loss of $7,690,517 and a net deficit of $12,461,020.

Six other governments have negative trends in this indicator, meaning that the auditors have doubts about their ability to continue as a going concern. Allen Park (panel B), Hamtramck (panel D), Benton Harbor (panel F), Inkster (panel I), and Royal Oak (panel K) received a going concern comment for the most recent fiscal year when they had no such comment in FY 2008.

Detroit (panel A) has a going concern comment in FY 2013 related to its bankruptcy, although no comment exists in the FY 2008 or FY 2004 audit reports. Detroit's bankruptcy ended in December 2014, 17 months after it started. Many stakeholder groups, including police and fire retirees, came together with proposals to slash more than $7 billion in liabilities and reinvest $1.7 billion in services over the next 10 years (Bomey 2014). The next few years of audited annual financial statements will show whether the reductions in salaries and wages, increase in tax revenue with enhanced collection efforts, increase in state revenue sharing, and reductions in employee and retiree benefits will be sufficient to keep it from sliding back into some level of fiscal distress. (Bomey 2014).

5. Conclusions and Recommendations

Accountability is the cornerstone of government financial reporting, as discussed early in GASB Concepts Statement No. 1. So when we see a high number of governmental entities in fiscal distress, we ask, what went wrong with our system of required annual audited government financial statements? Did the accounting standards setters fail to design an understandable financial report? Did the governing body fail to read and use financial reports? In this paper, we show that the due process of setting accounting and financial reporting standards for state and local governments supplies decision makers with high-quality information relevant to solving governmental issues. The demand for such information by intermediaries educated to read it, such as bond raters, is likely high, but the demand for financial statements by governing bodies and citizens is an empirical question.

We suggest that, had certain governing bodies—such as city councils and public school boards—accessed, read, understood, and used financial reports on a regular basis, they would have seen the signs of impending fiscal distress for their governments. Governing bodies may have had the information from timely financial reports and just ignored it, or they didn't know what to do with it, or they couldn't legislatively or contractually do anything about impending fiscal crises. Governments are different from businesses—they have legally binding budgets, engage in nonexchange transactions (e.g., tax assessment and collection) to cover the cost of public services, and operate complex entrepreneurial activities, such as airports, water and sewer treatment systems, and hospitals. Council and board members may be more familiar with business financial information than they are with governmental accounting information; therefore, they might not use it effectively in making public service decisions.

Jonas and Young (1998) claim that the standards-setting process needs more emphasis on how information is used and less emphasis on how information is currently accounted for. Their recommendation came right as the GASB was rolling out its overhaul of the government financial reporting model (GASBS 34 in 1999). We propose some steps that government officials can take to more effectively use financial reports to anticipate and fend off fiscal distress. Step 1: find out if and how often appointed and elected officials and citizens use financial statements, and government-wide statements in particular, when making decisions. Financial statements should be presented at each monthly council meeting and explained by someone with financial expertise. Step 2: train council and board members to analyze and understand those statements, particularly the two government-wide statements that present the big picture of the government as a whole. Step 3: experiment with alternative formats of financial reporting that would not only help internal users assess the government's short- and long-term performance, but may also help citizens and their intermediaries who are external to the government to understand the financial and economic health of the government. Taking these steps should increase the likelihood that decisions made are supported by financial statement information. Each of these three recommendations is detailed in this section.

5.1. *Surveys or Interviews with Elected Officials*

Empirical evidence needs to be collected to assess the extent to which government financial statements are used in times of fiscal distress—which statements and by whom? If the level of usage is low when the quality of financial information and the standards on which they are based is high, then where is the disconnect? Empirical evidence is needed to determine why this is the case. At a local level, a government's managers can undertake this research project by surveying, or, better yet, interviewing the current board or council members and asking questions on their perceptions and assessment of (1) the accessibility of financial statements, (2) the extent to which financial statements are used, (3) the usefulness of financial statements in making short-term budget decisions, and (4) the usefulness of financial statements in making long-term operational decisions. See table 13 for a set of eight questions that cover these four factors.

Table 13. Survey or Interview with Government Decision Makers

The following questions can be asked of appointed and elected government officials (and extended to citizens) using a 7-point Likert scale, such as this one:

1	2	3	4	5	6	7
Never			Sometimes			All the time

I. Accessibility of financial statements
Q1**:** Does management present to board or council members a full set of financial statements at each regular meeting?
Q2: Are the annual, quarterly, and monthly financial statements available on the government's website for all decision makers to use?

II. Level of usage of financial statements
Q3: As a board or council member, do you examine the financial statements before each meeting?
Q4: Do you ask questions during the regular meetings about information on the financial statements?

III. Usefulness of financial statements in making short-term budget decisions
Q5: How useful are the financial statements in approving or monitoring performance of the government compared to the annual budget?
Q6: Do board or council members refer to numbers on the financial statements when making proposals about the budget?

IV. Usefulness of financial statements in making long-term operational decisions
Q7: How useful are the financial statements in making decisions about approving long-term contracts with employees, labor unions, or vendors?
Q8: Do board or council members refer to numbers on the financial statements when discussing long-term contracts with employees, labor unions, or vendors?

If government managers want to separate themselves from this task of gathering information from board or council members with whom they interact on many different levels, they can engage their external public accountant to conduct these interviews, or they may be able to use the time and enthusiasm of local college students studying governmental accounting or public administration in an academic-service learning (AS-L) setting. AS-L is an instructional strategy in which the professor matches up students with organizations in the community so that students can actively engage in learning the course objectives while serving the local organization and then reflect upon the experience. When done well, students and organizations benefit equally from the experience, making AS-L different from volunteerism or internships.

5.2. *Government Financial Reporting Training Module*

Elected and appointed government officials can develop the ability to read and analyze financial statements so that data-driven decision making becomes the norm by participating in training modules. Teams of three or four people work with a facilitator who has governmental accounting expertise based on a government's comprehensive annual financial report (for a city) or an annual financial report for a school system or small governmental unit. Key learning objectives can be divided into one-hour modules in which participants look at financial information, discuss it with their team members, and then demonstrate their individual understanding of the topic by taking a 10-question multiple-choice quiz such as the one in table 15.

Four learning objectives are identified that relate to locating financial information, assessing the adequacy of the net position, explaining revenue sources of the government, and distinguishing information helpful in short-term and long-term decision making. Calculating the rainy day fund of the government as a whole using accrual rather than cash as a basis of accounting can be a valuable exercise to keep officials focused on the consequences of today's decisions on future generations. This instructional exercise can facilitate discussion among decision makers with different perspectives and roles in the government. Working with colleagues in teams to discuss the issues and then assessing learning at the individual level is designed to make the most efficient and effective use of a one-hour module as a training exercise. Participants will be quizzed at the end of each module and grades on those quizzes will

Table 15. Training Modules on Analyzing Governmental Financial Reports

Module	Learning objective: At the end of this training, you will be able to:	Active learning tasks	Assessment (10-question quiz)
1.	Locate financial and economic information about a government unit.	• Obtain and skim each page of the government's most current comprehensive annual financial report. • Discuss the purpose of each section of the report with your team. • Answer 10 questions, provide the dollar amount and page number to support each of your answers.	Exceeds expectations: 8 of 10 correct Meets expectations: 5 to 7 correct Does not meet expectations: <5 correct
2.	Assess the adequacy of the net position of the government as a whole.	• Review the difference between assets and liabilities for the government as a whole. • Discuss different classifications of net position with your team. • Determine the amount of "rainy day funds" the government has and describe the change in that number from past years. How does that amount compare to governments of similar size?	Exceeds expectations: 8 of 10 correct Meets expectations: 5 to 7 correct Does not meet expectations: <5 correct
3.	Explain which type of revenues cover the cost of governmental functions.	• Review the expenses of governmental functions on the government-wide statement of activities. • Discuss the excess of expenses over revenues dedicated to programs with your team and decide whether general revenues are sufficient to cover that net cost. • Explain the causes for the increase or decrease in net position for the current year and the change in that number from the prior year.	Exceeds expectations: 8 of 10 correct Meets expectations: 5 to 7 correct Does not meet expectations: <5 correct
4.	Distinguish between short-term and long-term decision making.	• Review the governmental fund balance sheet and operating statement. • Discuss the reconciliations of the governmental fund balances and governmental activities net position and the reconciliation of the changes in those with your team. • Determine the effect on the financial statements of renting all computer equipment compared to purchasing that equipment for the city's governmental operations.	Exceeds expectations: 8 of 10 correct Meets expectations: 5 to 7 correct Does not meet expectations: <5 correct

be translated into the number of participants that exceed expectations, meet expectations, and do not meet expectations. As the percentage of participants exceeding expectations increases over time, the learning objectives can be expanded. This exploration of the publicly available audited financial statements of the government will point out to government managers how important it is to make this information readily available on government websites or dedicated intranets.

5.3. *Balanced Scorecards*

As government managers and elected officials develop their ability to read and analyze GAAP financial statements, they may realize that citizens and residents need an easier-to-understand summary to assess performance of council and board officials. A balanced scorecard prepared by many businesses may be just the right visual summary to show transparency and accountability. A balanced scorecard is an integrated set of both financial and nonfinancial performance measures that come from a business's strategic plan. As described by Kaplan and Norton (1996), performance measures are grouped into four categories: financial, customer, internal business processes, and learning and growth.[50]

Many governments are modifying and experimenting with balanced scorecards to show the public how it has performed along a number of both financial and nonfinancial measures. Michigan, whose current governor is a certified public accountant, initiated a Michigan Dashboard (table 16), a derivation of Kaplan and Norton's balanced scorecard, to show progress on strategic initiatives.

[50] Robert Kaplan from Harvard University and David Norton, a consultant, were not the first to design balanced scorecards, but they were among the first to popularize this management accounting strategy.

Table 16. Excerpts from Michigan's Dashboard for 2013–2014

ECONOMIC STRENGTH	Prior (2012)	Current (2013)	Progress
Monthly unemployment rate	8.9%	7.5%	↑
Real gross domestic product	1.5%	2.0%	↑
Percent of structurally deficient bridges	12.31%	11.78%	↑
Real personal income per capita	$28,350	$28,719	↑
Children living in poverty	25%	25%	=
HEALTH AND EDUCATION			
Infant mortality (per 1,000 births)	7.4	7.3	↑
Obesity in the population (adult)	31.3%	31.1%	↑
Third grade reading proficiency	68.1%	70.0%	↑
ACT college readiness benchmarks	18.1%	17.8%	↓
Population with bachelor's degree or higher (>25 yrs)	25.6%	26.0%	↑
VALUE FOR MONEY GOVERNMENT			
Credit rating:			
Moody's	Aa2	Aa2	=
Standard & Poor's	AA (stable)	AA (stable)	=
Fitch	AA (pos)	AA (stable)	=
Government debt burden per capita	$800	$785	↑
State government operating cost as a percent of GDP	14.1%	12.9%	↑
State and local government operating cost as a percent of GDP	24.7%	23.3%	↑
Access to state government: number of online services	N/A	356	N/A
QUALITY OF LIFE			
State park popularity: annual visits per capita	2.60	2.47	↓
Population change (ages 25–34)	−.2%	−.1%	↓
Monitored beaches with no closures or unsafe advisories	76%	80%	↑
PUBLIC SAFETY			
Violent crime rates (per 100,000 population)	442.8	454.5	↓
Property crime rates (per 100,000 population)	2,544.6	2,530.5	↑
Individuals fatally or seriously injured in traffic accidents	6,612	6,234	↑

Source: MI Dashboard, downloaded at www.michigan.gov/midashboard/. Note that some indicators are from the 2013–2014 period, 2012–2013 period, and 2011–2012 period.
Note: ↑ indicates a positive trend, ↓ indicates a negative trend, and = indicates no change.

The Michigan legislature passed two bills that require each state department to have a strategic mission, vision, goals, and balanced scorecard.[51] A government in fiscal distress could easily modify the Michigan Dashboard and present financial and economic performance measures as shown in the panels in the appendix. A target could be set for each financial

[51] Michigan Public Acts 538 and 539, signed into law January 2, 2013.

indicator and the comparison between the current and prior year could be flagged as a positive or negative change or no change at all. Government managers and council and board members would then learn to use information on the government-wide financial statements on a monthly basis in order to assess whether there was good news on which to reward people or bad news for which action needs to be taken. GASB's service efforts and accomplishments website (www.seagov.org) provides guidance on financial and nonfinancial performance indicators that may be worth measuring, reporting, and then managing.

We conclude that GASB, the governmental standards setter, produced an improved financial reporting model in 1999 by adding accrual-based financial statements that focus on the big picture to the traditional fund-based financial statements that focused on the short-term budget for governmental activities. More than 10 years later, we do not see evidence that the two government-wide statements are being used. We propose three ways that governments can increase their chances of staying out of or emerging from fiscal distress: (1) determine the extent to which their own government officials use the government-wide statements, (2) train those officials to read and analyze those statements, and (3) adapt alternative reports to share with the public, such as balanced scorecards or dashboards, that may be easier for the public to consume. These strategies should help governments make short- and long-term data-driven decisions that will head off fiscal emergencies.

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List of Acronyms and Initialisms

AF	agency fund
AICPA	American Institute of Certified Public Accountants
ASC	*Accounting Standards Codification*
A-SL	academic-service learning
ASR	Accounting Series Release
CPA	certified public accountant
CAFR	Comprehensive Annual Financial Report
CPF	capital projects fund
DSF	debt service fund
ED	exposure draft
EF	enterprise fund
FAF	Financial Accounting Foundation
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FY	fiscal year
GAAFR	*Governmental Accounting, Auditing, and Financial Reporting*
GAAP	generally accepted accounting principles
GAAS	generally accepted auditing standards
GAGAS	generally accepted government auditing standards
GAO	Government Accountability Office
GARS	Governmental Accounting Research System
GASAC	Governmental Accounting Standards Advisory Council
GASB	Governmental Accounting Standards Board
GASBS	Governmental Accounting Standards Board Statement
GF	General Fund
GFOA	Government Finance Officers Association
GO	general obligation
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IPSASB	International Public Sector Accounting Standards Board
ISF	internal service fund
ITF	investment trust fund
L3C	low-profit limited liability company
LLC	limited liability company
LLP	limited liability partnership
MD&A	Management's Discussion and Analysis
MFOA	Municipal Finance Officers Association

NCGA	National Council on Governmental Accounting
NGO	nongovernmental organization
NPO	nonprofit organization
NTEE	National Taxonomy of Exempt Entities
OCBOA	other comprehensive bases of accounting
OMB	Office of Management and Budget
PA	Public Act
PC	professional corporation
PCAOB	Public Companies Accounting Oversight Board
PDF	portable defined format
PF	permanent fund
PPTF	private-purpose trust fund
PTF	pension trust fund
RSI	required supplementary information
SAS	Statement on Auditing Standard
SEC	Securities and Exchange Commission
SFAC	Statement of Financial Accounting Concepts
SFAS	Statement of Financial Accounting Standard
SFFAS	Statement of Federal Financial Accounting Standards
SRF	special revenue fund

Note: Section 2.2 lists member organizations of the GASAC and related acronyms.

Appendix: Key Governmental Performance Measures for 2003, 2008, and 2013 for Selected Michigan Governments

Legend for all panels:

- Numbers are in dollars, unless otherwise indicated.
- N/A means "not available."
- The column header "Recent trend" refers to the change from FY 2008 to FY 2013. A + indicates a positive trend; a − indicates a negative trend.

PANEL A: City of Detroit

	FY 2004	FY 2008	FY 2013	Recent trend
From government-wide statements				
Unrestricted net position: governmental activities	(315,218,872)	(687,464,129)	(1,714,975,464)	−
Change in net position: governmental activities	(237,401,909)	(117,616,122)	(127,391,872)	−
Working capital ratio: governmental activities	1.32/1	1.12/1	.95/1	−
Non-current liabilities: governmental activities	1,300,806,463	2,746,060,335	3,378,423,486	−
Unrestricted net position: business-type activities	283,585,593	186,210,525	(640,389,229)	−
From governmental fund statements				
Unassigned GF fund balance	(95,012,523)	(219,158,137)	(132,560,895)	+
Change in GF fund balances	(78,224,172)	(52,944,815)	196,505,908	+
From notes to statements and other required supplementary information				
Pension plan funded ratio*	N/A	100.9/110.5%	77.0/96.1%	−
other postemployment benefits liability		146,509,186	766,985,393	−
GF expenditures/appropriations	.85/1	.70/1	.56/1	−
From statistical section of Comprehensive Annual Financial Report				
Debt margin Outstanding debt/debt limit	582,081,000 55.94%	684,843,000 54.50%	519,053,000 66.69%	−
# of employees (full-time equivalent)	16,949	13,640	8,912	+
Population from last census	951,270	951,270	713,777	−
From Audit Report				
Unqualified audit opinion	No	Yes	Yes	+
Going concern comment	No	No	Yes	−

* The city has a general employees' retirement system and a police and fire retirement system.
Note: GF = General Fund.

PANEL B: City of Allen Park

	FY 2004	FY 2008	FY 2013	Recent trend
From government-wide statements				
Unrestricted net position: governmental activities	1,280,317	5,636,251	(31,444,767)	–
Change in net position: governmental activities	(5,200,187)	(1,815,843)	(12,360,652)	–
Working capital ratio: governmental activities	2.92/1	3.09/1	1.45/1	–
Non-current liabilities: governmental activities	8,173,114	7,364,895	36,158,069	–
Unrestricted net position: business-type activities	1,955,126	4,490,942	(2,392,420)	–
From governmental fund statements				
Unassigned GF fund balance	0	3,457,604	(1,002,763)	–
Change in GF fund balances	(777,875)	1,613,092	162,960	–
From notes and required supplementary information				
Pension plan funded ratio	99.1%	82.8%	71.8%	–
OPEB liability			27,121,009	
GF expenditures/appropriations	1.02/1	.96/1	.98/1	+
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population	N/A	N/A	N/A	
From Audit Report				
Unqualified audit opinion	Yes	Yes	Yes	+
Going concern comment	No	No	Yes	–

Note: CAFR was not prepared, only general-purpose external financial statements. GF = General Fund.

PANEL C: City of Flint

	FY 2004	FY 2008	FY 2013	Recent trend
From government-wide statements				
Unrestricted net position: governmental activities	(17,403,520)	(66,676,216)	(158,391,840)	–
Change in net position: governmental activities	(416,269)	(48,581,579)	7,724,280	+
Working capital ratio: governmental activities	2.21/1	2.31/1	2.83/1	+
Non-current liabilities: governmental activities	13,540,296	81,147,838	160,588,444	–
Unrestricted net position: business-type activities	97,377,129	97,377,129	8,278,835	–
From governmental fund statements				
Unassigned GF fund balance	(7,871,141)	(7,046,820)	(12,895,642)	–
Change in GF fund balances	6,197,665	(13,221,064)	6,289,208	+
From notes and required supplementary information				
Pension plan funded ratio	N/A	79.7%	61.1%	–
OPEB liability			*	
GF expenditures/appropriations	.97/1	.96/1	.94/1	–
From statistical section of CAFR				
Debt margin Outstanding debt/debt limit	123,804,229 5.10%	119,336,740 10.79%	46,432,068 16.58%	–
# of employees (full-time equivalent)	1,039.0	1,156.2	546.0	+
Population	118,596	112,857	99,763	–
From Audit Report				
Unqualified audit opinion	Yes	Yes	Yes	+
Going concern comment	No	No	No	+

* Notes say they are on a pay-as-you-go basis.
Note: GF = General Fund.

PANEL D: City of Hamtramck

	FY 2004	FY 2008	FY 2013	Recent trend
From government-wide statements				
Unrestricted net position: governmental activities	N/A	5,056,477	(7,311,247)	–
Change in net position: governmental activities	N/A	4,103,565	(1,251,645)	–
Working capital ratio: governmental activities	N/A	4.59/1	2.65/1	–
Non-current liabilities: governmental activities	N/A	5,474,540	7,281,696	–
Unrestricted net position: business-type activities	N/A	1,074,013	2,977,717	+
From governmental fund statements				
Unassigned GF fund balance	140,173	845,643	916,732	+
Change in GF fund balance	(872,906)	436,460	1,703,676	+
From notes and required supplementary information				
Pension plan funded ratio	65%	68%	54.2%	–
OPEB liability			2,289,525	
GF expenditures/appropriations	1.16/1	.95/1	.86/1	–
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population	N/A	N/A	N/A	
From Audit Report				
Unqualified audit opinion	No	No	Yes	+
Going concern comment	No	No	Yes	–

Note: GASBS 34 financial statements were not available until FY 2008; CAFR was not prepared, only general purpose external financial statements. GF = General Fund.

PANEL E: City of Lincoln Park

	FY 2004	FY 2008	FY 2013	Recent trend
From government-wide statements				
Unrestricted net position: governmental activities	1,929,082	2,460,298	(12,113,563)	–
Change in net position: governmental activities	(2,730,964)	(1,483,033)	(7,185,376)	–
Working capital ratio: governmental activities	3.24/1	3.90/1	3.39/1	–
Non-current liabilities: governmental activities	5,589,632	7,091,689	17,191,839	–
Unrestricted net position: business-type activities	1,983,940	3,500,856	3,810,418	+
From governmental fund statements				
Unassigned GF fund balance	4,094,390	2,590,117	(91,426)	–
Change in GF fund balance	(971,240)	513,963	(2,135,552)	–
From notes and required supplementary information				
Pension plan funded ratio*	N/A	42.02/53.79%	28.0/35.0%	–
OPEB liability			12,069,944	
GF expenditures/appropriations	.98/1	.91/1	1.00/1	+
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population from last census	N/A	N/A	N/A	
From Audit Report				
Unqualified audit opinion	No	No	Yes	+
Going concern comment	No	No	No	+

* The city has a municipal retirement fund and a police/fire retirement fund.
Note: CAFR was not prepared, only general-purpose external financial statements. GF = General Fund.

PANEL F: City of Benton Harbor

	FY 2004	FY 2008	FY 2013	Recent trend
From government-wide statements				
Unrestricted net position: governmental activities	(2,122,808)	(4,402,939)	(5,954,137)	–
Change in net position: governmental activities	615,280	(1,161,967)	(604,989)	+
Working capital ratio: governmental activities	1.50/1	.53/1	.50/1	–
Non-current liabilities: governmental activities	861,571	2,478,854	7,211,260	–
Unrestricted net position: business-type activities	8,872,535	7,364,417	13,266,243	+
From governmental fund statements				
Unassigned GF fund balance	(2,163,478)	(2,921,194)	(1,285,115)	+
Change in GF fund balance	(586,088)	(235,139)	1,156,343	+
From notes and required supplementary information				
Pension plan funded ratio*	N/A	74.4/73.8%	47.0/53.0%	–
OPEB liability			0	
GF expenditures/appropriations	1.01/1	1.04/1	.91/1	–
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population	N/A	N/A	N/A	
From Audit Report				
Unqualified audit opinion	Yes	No	No	–
Going concern comment	No	No	Yes	–

* The city has a general employees retirement fund and a police and fire retirement fund.
Note: CAFR was not prepared, only general-purpose external financial statements. GF = General Fund.

PANEL G: City of Ecorse

	FY 2004	FY 2008	FY 2013	Recent Trend
From government-wide statements				
Unrestricted net position: governmental activities	(41,750)	(14,275,722)	(14,958,473)	–
Change in net position: governmental activities	1,479,208	(2,680,039)	315,253	+
Working capital ratio: governmental activities	9.52/1	.29/1	4.78/1	+
Non-current liabilities: governmental activities	6,405,534	5,953,045	19,116,436	–
Unrestricted net position: business-type activities	7,009,099	7,649,736	1,357,854	–
From governmental fund statements				
Unassigned GF fund balance	5,413,583	(9,270,027)	965,643	+
Change in GF fund balance	1,271,074	(4,003,752)	1,339,328	+
From notes and required supplementary information				
Pension plan funded ratio	N/A	63.0%	48.1%	–
OPEB liability			1,406,163	
GF expenditures/appropriations	1.43/1	1.44/1	.90/1	+
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population	N/A	N/A	N/A	
From Audit Report				
Unqualified audit opinion	Yes	No	Yes	+
Going concern comment	No	Yes	No	+

Note: CAFR was not prepared, only general-purpose external financial statements. GF = General Fund.

PANEL H: City of Pontiac

	FY 2004	FY 2008	FY 2013	Recent Trend
From government-wide statements				
Unrestricted net position: governmental activities	(32,359,527)	(31,964,956)	(47,757,057)	–
Change in net position: governmental activities	(2,260,716)	8,777,308	8,390,108	–
Working capital ratio: governmental activities	.68/1	1.22/1	1.86/1	+
Non-current liabilities: governmental activities	21,709,223	39,405,345	53,042,454	–
Unrestricted net position: business-type activities	19,134,231	12,610,011	2,394,201	–
From governmental fund statements				
Unassigned GF fund balance	(21,278,858)	(7,071,957)	32,968	+
Change in GF fund balance	(8,356,549)	(929,717)	4,300,677	+
From notes and required supplementary information				
Pension plan funded ratio*	N/A	153.9/111.7%	153.5/87.9%	–
OPEB liability			27,302,126	
GF expenditures/appropriations	1.11/1	.99/1	1.00/1	+
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population	N/A	N/A	N/A	
From Audit Report				
Unqualified audit opinion	No	Yes	Yes	+
Going concern comment	No	No	No	+

* The city has a general employees' retirement system and a police and fire retirement system.

Note: City did not provide more than one year of government-wide statements. CAFR was not prepared, only general-purpose external financial statements. GF = General Fund.

PANEL I: City of Inkster

	FY 2004	FY 2008	FY 2013	Recent Trend
From government-wide statements				
Unrestricted net position: governmental activities	(3,705,829	(684,800)	(19,125,565)	–
Change in net position: governmental activities	(1,882,283)	467,758	836,718	+
Working capital ratio: governmental activities	1.75/1	1.47/1	.52/1	–
Non-current liabilities: governmental activities	13,366,642	15,041,459	15,315,271	–
Unrestricted net position: business-type activities	4,897,237	3,434,687	431,425	–
From governmental fund statements				
Unassigned GF fund balance	811,035	1,000,229	(3,446,167)	–
Change in GF fund balance	158,538	277	178,083	+
From notes and required supplementary information				
Pension plan funded ratio*	N/A	N/A	83.9/85.0%	
OPEB liability			9,481,583	
GF expenditures/appropriations	1.15/1	.98/1	1.06/1	–
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population	N/A	N/A	N/A	
From audit report				
Unqualified audit opinion	Yes	Yes	Yes	+
Going concern comment	No	No	Yes	–

* The city has a general employee's retirement system and a police and fire retirement system.
Note: CAFR was not prepared, only general-purpose external financial statements. GF = General Fund.

PANEL J: City of River Rouge

	FY 2004	FY 2008	FY 2013	Recent Trends
From government-wide statements				
Unrestricted net position: governmental activities	N/A	(12,722,283)	(12,843,834)	–
Change in net position: governmental activities	N/A	528,501	(558,700)	–
Working capital ratio: governmental activities	N/A	.73/1	1.31/1	+
Non-current liabilities: governmental activities	N/A	9,764,667	13,543,722	–
Unrestricted net position: business-type activities	N/A	1,989,275	549,275	–
From governmental fund statements				
Unassigned GF fund balance	(3,040,508)	2,395,406	170,181	–
Change in GF fund balance	(117,426)	270,990	1,318,586	+
From notes and required supplementary information				
Pension plan funded ratio*	62.8/75.16%	50.93/60.38%	50.1/65.2%	+
OPEB liability			4,897,270	
GF expenditures/appropriations	1.01/1	.96/1	.94/1	–
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population	N/A	N/A	N/A	
From Audit Report				
Unqualified audit opinion	No	No	Yes	+
Going concern comment	No	Yes	No	+

* The city has a general employees' pension plan and a police and fire pension plan.
Note: GASBS 34 financial statements were not available until FY 2008. CAFR was not prepared, only general-purpose external financial statements. GF = General Fund.

PANEL K: Charter Township of Royal Oak

	FY 2004	FY 2008	FY 2013	Recent Trends
From government-wide statements				
Unrestricted net position: governmental activities	1,251,763	248,922	(447,750)	–
Change in net position: governmental activities	2,645,568	(17,347)	(74,112)	–
Working capital ratio: governmental activities	1.44/1	1.10/1	2.36/1	+
Non-current liabilities: governmental activities	1,349,351	1,015,301	2,407,166	–
Unrestricted net position: business-type activities	0	267,694	217,629	–
From governmental fund statements				
Unassigned GF fund balance	1,049,179	28,506	26,945	–
Change in GF fund balance	249,996	13,315	(11,045)	–
From notes and required supplementary information				
Pension plan funded ratio	N/A	N/A	206%	
OPEB liability			0	
GF expenditures/appropriations	2.07/1	1.06/1	1.09/1	–
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population	N/A	N/A	N/A	
From Audit Report				
Unqualified audit opinion	Yes	Yes	Yes	+
Going concern comment	No	No	Yes	–

Note: CAFR was not prepared, only general-purpose external financial statements. GF = General Fund.

PANEL L: City of Highland Park

	FY 2004	FY 2008	FY 2013	Recent Trends
From government-wide statements				
Unrestricted net position: governmental activities	N/A	(45,358,872)	(45,731,094)	–
Change in net position: governmental activities	N/A	(17,537,623)	3,123,964	+
Working capital ratio: governmental activities	N/A	1.46/1	2.18/1	+
Non-current liabilities: governmental activities	N/A	55,178,215	46,886,221	+
Unrestricted net position: business-type activities	N/A	(4,248,580)	(12,175,000)	–
From governmental fund statements				
Unassigned GF fund balance	(18,297,191)	(1,970,087)	2,096,642	+
Change in GF fund balance	2,231,526	3,549,861	(206,950)	–
From notes and required supplementary information				
Pension plan funded ratio*	N/A	5.6/6.6%	43.5/5.3%	+
OPEB liability			4,466,615	
GF expenditures/appropriations	.87/1	3.66/1	.90/1	+
From statistical section of CAFR				
Debt margin	N/A	N/A	N/A	
# of employees (full-time equivalent)	N/A	N/A	N/A	
Population from last census	N/A	N/A	N/A	
From audit report				
Unqualified audit opinion	No	No	Yes	+
Going concern comment	Yes	Yes	Yes	–

* The city has a general employees' retirement system and a police and fire retirement system.
Note: GASBS 34 financial statements were not available until FY 2008. CAFR was not prepared, only general-purpose external financial statements. GF = General Fund.