



THE EFFECTIVENESS OF SETTING GOVERNMENTAL ACCOUNTING STANDARDS The Case of Michigan Governments in Fiscal Distress

Accounting standards-setters such as the Governmental Accounting Standards Board (GASB) have built a generally accepted financial reporting model for local governments. Even though this model contains useful information and these reports are prepared and audited each year for states and most local governments, relevant policymakers do not appear to access and read this information as they are making financial and political decisions about public resources.

A new study for the Mercatus Center at George Mason University examines how government financial statements that follow generally accepted accounting principles provide useful information to decision makers. Local government decision makers should learn how to use this information to design stronger governments that avoid fiscal distress.

To read the study in its entirety and learn more about its authors, Susan P. Convery and Andrew J. Imdieke, please see [“The Effectiveness of Setting Governmental Accounting Standards: The Case of Michigan Governments in Fiscal Distress.”](#)

SUMMARY

The purpose of setting accounting standards, for either businesses or nonbusiness entities, is to improve the quality of the financial statements on which users of the standards base their decisions. Just as the governmental sector of the US economy is complex, so too is the governmental financial reporting model set up by the GASB. The effectiveness of its standards-setting process depends on whether financial statements based on generally accepted accounting principles promulgated by the GASB and others are used and understood, leading to well-informed decisions.

The public sector requires different financial reporting models than those used for the business and not-for-profit sectors. Governmental accounting standards-setting should be examined in the context of the process for setting generally accepted accounting principles (GAAP) for any

For more information, contact
Kyle Precourt, 703-993-8196, kprecourt@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Boulevard, 4th Floor, Arlington, VA 22201

organization. The two government-wide financial statements introduced by GASB in 1999 offer a tremendous amount of information about the “big picture” or long-term financial condition of a government—information that is useful to decision makers striving to keep local governments fiscally solvent and economically stable.

Looking to Michigan as a case study, the state government has set up a system that provides early warning, review, and monitoring for local governments that are in some level of fiscal distress. When financial stress is serious, the state may have to provide significant oversight of the local government through a variety of legal mechanisms. By examining financial statement indicators from fiscal years 2004, 2008, and 2013 for 12 Michigan local governments that were designated as being in fiscal distress, it is possible to identify positive “good news” and negative “bad news” trends discernible in GAAP financial statements. Examining financial statement indicators before serious financial stress can help prevent future crises requiring state government oversight.

KEY RECOMMENDATIONS

Fourteen years after the GASB introduced an improved financial reporting model that focuses on the big picture, many local governments have suffered fiscal distress that policymakers could have avoided if they had understood their governments’ financial statements. To make sure signs of impending fiscal distress are readily apparent, government officials should take three steps:

- 1) assess to what extent policymakers use financial statements following GAAP when making decisions,
- 2) consider using training modules to help policymakers who do not understand financial statements to develop financial analysis skills, and
- 3) use a “balanced scorecard”—a business performance measurement tool—to present financial information about the government and focus attention on tracking progress toward specific, agreed-upon financial goals.

Increasing the use and understanding of GAAP financial statements can increase the likelihood that decision-making is driven by quality accounting information and fiscal crises are averted.

CONCLUSION

The financial statements of state and local governments tell the story of the financial and political decisions policymakers have made and the way officials elected to serve the public interest have spent public resources. If governing bodies such as city and town councils made more of an effort to read and understand them, they would be in a better position to avoid future fiscal distress.