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Fund Balance Reporting. Local Governments' Compliance with GASB Statement №54

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by

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INTRODUCTION

Fund balance is a term that is used to describe the difference between assets and liabilities in the governmental fund. It represents the amount of funds that remain at the end of the fiscal year after all spending commitments have been completed (Stewart et al., 2013a). According to Gauthier (2009), it is the most widely discussed part of every annual financial report. Experts consider the fund balance as an indicator that allows one to evaluate the financial condition of the government and conclude on its ability to face unforeseen economic issues. Specifically, financial analysts and rating agencies are interested in determining the number of months that a government can finance general fund expenditures from its reserves (Kelly, 2013). When savings do not prove to be sufficient enough to cover unexpected economic downturns and serve stabilizing role, ratings tend to scale down and show unfavorable creditworthiness. There is also a potential need to borrow money or increase taxes.

Although the proper amount of fund balance may be argued, researchers suggest that maintaining and reporting savings should imply transparency, responsibility, and conformity with universal principles (see Allan, 1990; Gauthier, 2009). The Governmental Accounting Standards Board (GASB) is an organization that aims to establish and improve standards of state and local governmental accounting (GASB, 2016). It establishes generally accepted accounting principles (GAAP) that ensure greater accountability and well-informed decision making (GASB, 2015). Throughout the years, GASB has released over 80 statements and hundreds of recommendations for state and local governments. Of a specific interest for this research are publications that concern the reporting of the fund balance.

Issued in June of 1999, Statement № 34 was found to be ineffective in shaping financial report standards toward more clarity and consistency. While conditions for maintaining reserved fund balance were better understood by the users since it implied assigning assets for specific purposes, unreserved fund balance brought confusion and inconsistency into the reporting process (Kelly, 2013). Since government had an unclear level of discretion in determining whether funds should be designated for specific purposes or left undesignated to be spent at will, a great number of financial officers reported problems and errors in dealing with the unreserved fund balance (Kelly, 2013). In light of complaints and requests from the users, GASB conducted a survey following the implementation of Statement № 34 to find out that governments demonstrate significant differences in understanding the principles of fund balance accounting (GASB, 2006).

In response to the issue, the Governmental Accounting Standards Board released a statement № 54, in February of 2009. The objective of the statement was to spell out government fund type definitions in details, and to provide new fund balance classifications in order to improve financial reporting and make it easier to understand (GASB, 2009b). As shown in Table 1, it eliminated reserved and unreserved categories in favor of nonspendable, restricted, committed, assigned, and unassigned fund balance.

Table 1. New Categories of Fund Balance

Pre-GASB 54	GASB 54
Reserved	Nonspendable Restricted Committed
Unreserved	Assigned Unassigned

Moreover, governments were now required to disclose information about policies that regulate distribution of funds between categories, constraints that are imposed on the amounts, as well as their designation within the fund in the notes to the financial reports (GASB, 2009a).

The purpose of this research is to evaluate local government's compliance with classifications and information disclosure requirements introduced in the statement № 54. The aim of the research question is to provide insight by answering the question, has local governments' level of compliance improved since the implementation of GASB 54?

This research builds upon the work of Kelly (2013), who is the only known scholar that focuses on local government's compliance with GASB Statement №54. Specifically, Kelly examined 187 cities in FY 2011 and reveled a number of issues in local governments' reporting after examining their Comprehensive Annual Financial Reports (CAFRs). In her research, she examined CAFRs of two hundred cities with populations between 100,000 and 250,000 people. Due to availability issues and absence of statistical sections in several reports, the following data were drawn from 187 cities. Kelly found that ten cities did not adjust their FY 2011 reports to GASB №54 and were still reporting fund balances in reserved and unreserved sections (Kelly, 2013). Designation purposes and designation justifications were often in contradiction with regulations that apply for one of the five categories. For example, she discovered that notes for restricted fund balance often identified it being designated for contingencies, which contradicts with the new regulation that restricted fund balance assignment has to be externally imposed. Similarly, none of the cities were in compliance with GASB's requirements to provide notes about municipal policies or ordinance on assigning parts of committed fund balance for specific stabilization purposes. Unspecified contingencies were also identified in assigned fund balance, where funds can only be designated for projected shortfalls (Kelly, 2013; GASB, 2009a).

Similar to Kelly, this research considers available CAFRs of 545 cities, but with population over 50 thousand people for FY 2011 and FY 2014. The total number of the examined reports equals to 991. The list of cities used for this analysis was drawn from the 2006 International

City/County Management Association (ICMA) municipal yearbook, and data were collected on those cities whose financial information was readily available. ICMA is widely considered as one of the leading experts on municipal government issues, and should provide a reasonable source to develop a list of cities to assess local government's compliance with classifications and information disclosure requirements imposed by the GASB statement № 54. Reports from 2011 are studied in order to determine the obedience with new principles during the first year GASB № 54 went into effect. Additionally, the examination of FY 2014 reports from the same cities allowed the author to conduct comparative analysis and conclude the progress and the improvement level of cities' compliance with GASB's requirements within these four years. Table 2 (see Appendix A) provides information on a number of cities in every state that were selected for examination in this research.

This study enriches the limited literature on the latest practices of fund balance reporting and helps to determine compliance of local governments to GASB 54 four years after its implementation. The outcome of this research would allow conclusions to be drawn on the proportion of local governments that still need to adjust their reporting standards, and create a list of the most common mistakes and misconceptions in regards to obeying GASB's new classifications and information disclosure requirement in the notes to the financial statement.

CHAPTER II

LITERATURE REVIEW

GASB introduced Concept Statement № 1 called Objectives of Financial Reporting in May of 1987. The goal of the statement was to create a general purpose for external financial reports released by state and local governments (GASB, 1987). The statement recognized citizens, legislators, oversight agencies, investors and creditors as the main users of such reports (GASB, 1987). The objectives of external financial reports included comparing adopted budgets with actual financial results, examining financial conditions, determining compliance with accounting policies and regulations, and evaluating efficiency and effectiveness (GASB, 1987). Although majority of them now serve as widely accepted principles for the reports, Kelly (2013) states that the last objective still remains contradictory due to the uncertainty of parameters for such evaluation.

Consequently, concept Statement №1 aim was to improve transparency and compliance in government accounting, and draw more attention to financial reports as opposed to the sole focus on budget documents. According to Tyer (1993), many citizens and even elected officials often rely on budgetary data as the main source of information on the financial condition of the government. They are often unaware of the fund balance and its distribution as this information is typically found in audit reports (Tyer, 1993).

Wolkoff (1987) conducted research on identifying formal reserves in local governments. In his examination of the 27 most populated cities in the United States, he discovered that only a few of them maintained formal reserve funds and speculated that the rest had some type of informal savings. After the financial crises of 1980-1982 that encouraged public administrators to increase reserve amounts, new regulations and statements had to come into effect to regulate fund balance reporting and proper designation, increase awareness of citizens and legislators, and help to determine the proper level of savings.

Allan (1990) provided guidance for budget officers and financial managers in developing the policy for appropriate levels of unreserved fund balance in the lack of nationally uniform standards or recommendations. Specifically, he argued that governments must have policies that would list their fiscal objectives and regulate the levels of unreserved fund balances for specific purposes or contingencies to increase public awareness.

Transparency and Stabilization Funds

Stewart et al. (2013a) argue that it may be politically risky for budget officers to disclose information on unreserved fund balance as interest groups, taxpayers and department heads would immediately claim it for programs and other interests that have a primary effect on them. Many opponents of fund balance accumulation argue that money has to stay in taxpayers' hands until needed to pay for services, and that if surplus exists, it should be returned to the taxpayer through tax cuts and tax refunds (Auerbach & Gale, 2001). To deal with this problem and explain the importance of maintaining the reserves, Allan (1990) suggests that financial managers provide taxpayers with detailed explanations of why certain resources were accumulated, and conditions under which these funds will be appropriated.

Stewart et al. (2013a) state that little knowledge about the level of reserves that local governments set aside raises questions about the ethical and financial management practices of government officials. Their study describes serious political and financial risks that come along with the lack of transparency, absence of oversight, and misappropriation of public funds. The authors also explain that the utilitarian prospective would justify not disclosing some available funds if such action results in greater good for the public, whereas the Kantian perspective would insist on promoting transparency and ethical behavior in any possible way.

As stated by Rose and Smith (2012), “Slack resources can help governments cope with economic uncertainty, absorb temporary shocks, cover cash flow problems, meet contingency needs, and even take advantage of investment opportunities” (p.187). Such resources can be accumulated in three different ways. First, accumulation in general fund balance can take place when expenditures are set at a lower level than projected income (Rose & Smith, 2012). Second, it may occur when revenues are intentionally underestimated, or when expenditures are deliberately overestimated (Rose & Smith, 2012). Third, governments can preserve resources in a separate budget stabilization fund, commonly referred to as a rainy day fund (Rose & Smith, 2012). In this case, the first form is more transparent for lawmakers and stakeholders, and therefore draws more attention (Rose & Smith, 2012). The second and third form are less visible to interest groups and legislators, and thus experience less political pressure (Rose & Smith, 2012).

Little is known about the number of local governments that maintain stabilization funds. According to Rose and Smith (2012), almost all states have adopted stabilization funds within the last decade. Partly due to the political pressure to limit their discretion over slack resources, states moved their remaining assets from general funds into a separate budget stabilization funds.

The empirical study of boom-bust cycles by Wang & Hou (2012) revealed that North Carolina counties do not demonstrate stabilization role of local governments. Although governmental grants revealed a small effect during the downturns, collected data show no counter-cyclical impact on expenditures (Wang & Hou, 2012). In contrast, Marlow (2005) found that unreserved general fund balance has counter-cyclical stabilization properties, and it “boosts negative expenditure gaps during downturn years by an estimated less than 1 percent in average municipalities" (p.70).

In his research of budget stabilizations in state governments, Wagner (2001) discovered that money held in the stabilization funds are mostly substitutable with the ones in the general fund. Moreover, analysis of available data allowed him to reveal that "US $1 per capita increase in budget stabilization fund increases state savings by roughly 44 to 49 cents over the period from 1974 to 1997" (Wagner, 2001, p.234). Consequently, these findings suggest that the impact of stabilization funds, that provide much less than dollar-for-dollar effects, would have much smaller effects on smoothing economic downturns that one can expect (Wagner, 2011).

Amount of Fund Balance

The proper level of fund balance remains to be a popular topic among politicians, public administrators, financial experts, budget analysts, and the general public. Stewart et al. (2013a) found that there was no consensus on the proper amount of the reserves that governments must uphold in order to meet unexpected economic challenges. In 2002, the Government Finance Officers Association (GFOA) released a recommendation for local governments to maintain from 5% to 15% of their general fund liabilities in unreserved fund balance. In 2009, GFOA published a statement encouraging local governments to preserve at least two months of expenditures for the purpose of unexpected expenses. Similar advice was found in the most recent recommendation from GFOA that was issued in September of 2015 (GFOA, 2015). It also states that governments should efficiently use its discretion to influence fund balance amounts based on the present circumstances (GFOA, 1990). For example, if a government experiences severe risks to face natural disasters or anticipate substantial reductions in state or federal aid, it should consider the increase of the fund balance amount to be able to deal with this challenge and avoid borrowing or the increase of taxes.

In their study of North Carolina counties, Wang and Hou (2012) revealed factors that affected the level of general fund balances in county governments. They found that property tax was the most significant contributor to the local savings, whereas intergovernmental grants had no significant impact due to the requirement that it has to be used within one fiscal year. Additionally, local option sales tax and wealth level proved to be major contributors to the amount of savings (Wang & Hou, 2012).

In their study of the connection between economic volatility and amounts of savings, Stewart et al. (2013b) considered counties of Illinois, North Carolina and Mississippi. The scholars found that unreserved fund balances of local governments increase at the same time as volatility growths in the most important revenue sources. Furthermore, governments modify their level of reserves based on the projected downturns, and use their savings to deal with fiscal problems (Stewart et al., 2013b). Despite volatility among main revenue streams, the researchers also revealed that unemployment and even ideology of the electorate significantly contribute to the amount of the fund balance.

Uncertainty about proper levels of savings as well as unclear levels of discretion exercised by local governments in the process of accumulation, preservation, designation and distribution of fund balance resulted in considerable differences in how governments understood and followed the standards for fund balance reporting (GASB, 2009b). According to the introductory section of the Statement №54, prior accounting terms were poorly defined and resulted in broad misunderstandings and release of inconsistent and noncomparable information (GASB, 2009a). Under the previous statement, governments had no uniformity in relating the same funds for the same purposes (GASB, 2009a). Moreover, restricted net assets category introduced under GASB №34 added even more misperceptions as its relationship to reserved fund balance was unclear (GASB, 2009a).

Emergence of GASB 54

Before GASB №54, the fund balance had to be reported in two categories: reserved and unreserved. Reserved fund balance included resources that the government was not able to spend (for example, inventory) and assets that could only be spent for a specific purpose (GASB, 2006). Unreserved fund balance is the portion of the fund balance that was not reserved for any specific purposes. At the discretion of local governments, some portions of unreserved fund balance could be designated to demonstrate intent to spend it for a specific purpose (GASB, 2006). However, it was not required, and even designated funds were not obligated to be spent for a previously specified purpose (GASB, 2006).

A significant number of participants in GASB's survey of users expressed their dissatisfaction with government reports due to the lack of details on reserved funds and the process of designation of unreserved fund balance (GASB, 2006). Particularly, users were interested in learning about external regulations that were defining the appropriation of the reserves, and understanding the rational for designating unreserved funds for specific purposes.

In order to enhance financial reporting, eliminate confusion and avoid further incompliance with accounting policies, the Governmental Accounting Standards Board produced Statement № 54 called Fund Balance Reporting and Governmental Fund Type Definitions in February of 2009 (GASB, 2009a). According to Gauthier (2009), three reasons influenced the GASB to reconsider its previous reporting principles and issue Statement №54: traditional terminology in financial reporting that was often misinterpreted, the use of different accounting categories that often led to inconsistencies, and the question on the helpfulness of financial statements to its users.

The Statement emphasized the importance of following the universal principles of fund balance reporting, and established hierarchy of new fund balance classifications in the following order: nonspendable, committed, assigned, and unassigned fund balance (GASB, 2009a). Governments are expected to establish policies that would determine the order in which unrestricted assets will be appropriated. If governments do not create such a policy, it is assumed that committed amounts are spent at first, followed by assigned, and at last unassigned amounts (Chase, 2009). The new classifications replaced reserved and unreserved fund balance, and local governments were required to implement them for periods beginning after June 15, 2010 (GASB, 2009b).

From now on, governments are required to specify accounting policies that were guiding them in distributing the funds among the new five categories of fund balance. The Statement obligates accounting officers to disclose this information in the notes to the financial statements (GASB, 2009a). As stated by Stewart (2009), the new requirements granted governments with an opportunity to disclose the anticipated use of their fund balances and to develop unified procedures to improve reporting and financial analysis. Surdick (2009) explained that the new statement enhanced government financial reporting by creating hierarchal classifications of fund balance based on the imposed constraints.

New Classifications of GASB 54

According to GASB № 54, the nonspendable fund balance category should contain amounts that cannot be spent by governments as it is either in nonspendable form or legally and contractually obligated to remain intact (Kelly, 2013). Examples include inventory and prepaid expenses, as well as the principal of a permanent fund and cemetery endowment (GASB, 2009).

Restricted fund balance represents amounts that are restricted for specific purposes externally by creditors, grantors, contributors, or laws of other governments, or "imposed by law through constitutional provisions or enabling legislation" (GASB, 2009a, p.4). Kelly (2013) notes that stabilization funds are rare in this category as it would imply the release of the state mandate.

Committed fund balance can be spent for specified purposes determined by the formal action of the highest level of local government's decision-making, such as the city council or board of trustee (GASB, 2009a). Committed amounts cannot be used for any other purposes until the government changes its designation by taking the same legal action that imposed constraints (ordinance or legislation) (GASB, 2009a). Stabilization funds may be used under this category, but its detailed usage for predetermined purposes must be set by policy or legal action of government. As explained in paragraph 20 of GASB (2009a), such specification as emergency would not allow governments to maintain stabilization funds in committed fund balance as it is impossible to provide sufficient details on the circumstances of the emergency situation a head of time. Similarly, "anticipated revenue shortfall" cannot be a valid justification unless governments manage to quantify shortfalls and prove that it has no connection with normal revenue shortfalls that take place throughout the fiscal year (GAS 54, Paragraph 20, p.9).

Assigned fund balance represents amounts that are intended to be spent for predetermined purposes, but do not fall under restricted or committed fund balance classification. The intent has to come from a government itself, or from officials or committees that were delegated the authority to allocate funds for specific purposes by the governing body (GASB, 2009a). Therefore, in contrast to committed fund balance, assigned funds do not have to be allotted by the "highest level of decision-making authority" (GASB, 2009a, p.6). Moreover, assigned fund balance may be used to cover projected budget deficits in the following fiscal year if it does not cause a negative amount of unassigned fund balance to occur (GASB, 2009a).

Unassigned fund balance in the general fund contains amounts that did not qualify for one of the five classifications. These assets are to be spent without any restrictions. The general fund has to be the only fund that reports a positive amount in unassigned fund balance (GASB, 2009a). According to Kelly (2013), it usually comprises the most significant chunk of nonspecific stabilization resources. As required by the statement (GASB, 2009a), if stabilization measures do not qualify for restricted or committed fund balance, governments are obligated to provide information on the authority that creates stabilization arrangements, rules on adding stabilization amounts, conditions that guide spending of stabilization reserves, and stabilization balance itself if it is not evident in the face of financial report (GASB 54, Paragraph 21).

CHAPTER III

RESEARCH JUSTIFICATION

As discovered in the review of the literature, a number of significant issues influenced the establishment of GASB statement №54. Upon release of the document in 2009, scholars, budget officers, financial managers and ordinary users expressed hopes that new standards would promote consistency, clarity and transparency. However, limited research has been done on the effects of GASB №54 after its implementation. In the study of 187 Comprehensive Annual Financial Reports for the first fiscal year after the new statement took effect, Kelly (2013) identified several areas where municipalities failed to comply with new requirements. Some cities continued to present their reports in pre-GASB 54 categories, and a majority did not specify the funds assignment schedule between the five new categories (Kelly, 2013). Moreover, a number of the reports demonstrated financial officers' confusion in following proper procedures for assigning stabilization funds, and improper designations were discovered in all applicable categories (Kelly, 2013).

The goal of this research is to examine compliance with GASB №54 for FY 2014 financial reports from 545 cities and compare it to the reports from FY 2011. The research question aims at finding out how the level of compliance changed after three years from the time when financial managers were first required to incorporate the new principles. According to GASB (2009a), the requirements for this statement are effective for periods that begin after June 15, 2010.

According to Kelly (2013), financial experts believe that the conditions of GASB №54 required local governments to revise and create new procedures and policies in order to be in compliance with the new statement. For some local governments, the time needed to establish new statutes and regulations, as well as the lack of experience of financial officers in adjusting their reports to newly created classifications, could result in compliance problems during FY 2011. Therefore, this research seeks to determine if compliance in FY 2014 improved in comparison to FY 2011 as governments and audit officers had more time to correct their misconceptions, clarify new requirements, and adjust policies and reports in accordance to the standards proposed in 2009.

For the purpose of this research, I used the list of 545 cities from the ICMA municipal yearbook with the population equal or above 50,000 people. A broad number of cities allowed me to obtain an accurate understanding of the compliance levels with GASB №54 across 49 states.

CHAPTER IV

DATA AND METHODOLOGY

As explained by Marsh et al. (2004) and Stewart et al. (2013a), the complexity of Comprehensive Annual Financial Reports (CAFRs) often prevent citizens, media and elected officials from understanding the real picture of government's financial condition. At the same time, CAFRs give its users the most precise information on government funds and its distribution.

The data for this research were collected from CAFR reports and is primarily located in balance sheets of governmental funds and notes to financial statements. Balance sheets are examined to determine (1) basic compliance with structural arrangements of GASB №54 and the distribution of fund balance amounts among five classifications. The notes to financial statements are examined in order to reveal compliance with the requirement to provide (2) procedures for assigning a stabilization fund (authority that establishes it and conditions under which it can be spent), (3) information on the legal process and formal actions, and an explanation of authority that imposed constraints on committed and assigned funds, (4) and the description of any formally adopted minimum fund balance policies (Chase, 2009 & GASB, 2009a).

Basic structural arrangements (1) of fund balance reporting in the balance sheet is explained in detail throughout GASB №54. To satisfy this compliance component, it is expected that the balance sheet of governmental funds will be organized in accordance with the new standards and demonstrate nonspendable, restricted, committed, assigned and unassigned categories instead of pre-GASB 54 reserved and unreserved fund balance categories. GASB requires that both components of nonspendable fund balance may be maintained intact or separately. Restricted fund balance should be displayed in either aggregate form or differentiate between the main restricted purposes. Likewise, committed and assigned fund balances may be either presented in detail or displayed in the aggregate (GASB 54, 2009a).

Stabilization arrangements (2) are required to be disclosed in the notes to financial statements despite its relation to one of the new classification categories. According to the Paragraph 26 (GASB, 2009a), the following data have to be disclosed in the notes to the financial statements:

a. The authority for establishing stabilization arrangements (for example, by statute or ordinance)

b. The requirements for additions to the stabilization amount

c. The conditions under which stabilization amounts may be spent

d. The stabilization balance, if not apparent on the face of the financial statements. (p.12)

Information that has to be revealed on the formal actions and authority that imposes constraints on committed and assigned funds (3) is prescribed by Paragraph 23 (GASB, 2009a). As it states, governments have to release information on its highest level of decision-making authority and the type of legal actions that is necessary for creating or modifying committed fund balance (GASB 54, 2009a). As for assigned fund balance, it is required to reveal government bodies and officials that are legally authorized to allocate amounts for specific purposes (GASB 54, 2009a). Moreover, notes have to disclose policies, statutes or ordinances that determine such authorization.

Description of any formally adopted minimum fund balance policies (4) is required by Paragraph 27 (GASB, 2009a). It states that “if a governing body has formally adopted a minimum fund balance policy, it should describe the policy established by the government that sets forth the minimum amount in the notes to financial statements” (GASB 54, 2009a).

Each available Comprehensive Annual Financial Report from 545 cities is examined in order to determine its compliance with the four requirements listed above. Compliance for each parameter is recorded as either “satisfactory”, “unsatisfactory” or “not applicable”. The not applicable mark is only used for parameters 2 and 4, because governments are not required to establish stabilization arrangements or minimum fund balance policies. Therefore, this research only takes into consideration those governments that openly admit that they maintain stabilization funds or have a specific rule for a minimum fund balance. In these cases, compliance is evaluated based on the disclosure of the required information.

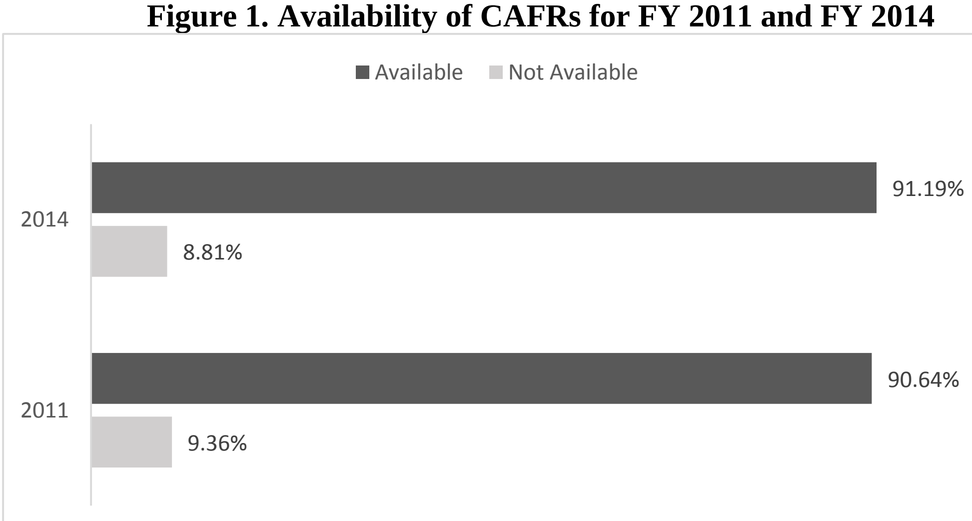
Analysis of the results for FY 2011 and FY 2014 allow one to track progress that is made in every category and determine which one made the most improvement and had the least and most issues with compliance regulations. The percentage of cities in compliance from FY 2011 in comparison to FY 2014 would allow one to determine if compliance levels improved from when GASB № 54 was originally incorporated into financial reports.

CHAPTER V

RESEARCH FINDINGS AND DISCUSSION

Comprehensive Financial Reports for FY 2011 were not always available online. Out of 545 cities considered in this research, 51 did not provide access to their CAFRs. Most of the municipalities did not upload files to cities' online resources, six had their entire websites down, and four acknowledge the existence of CAFRs, but required filling a request form in order to obtain the documents. The cities that had no CAFR available on their website were not contacted for a copy of the document. Only the CAFRs available online were examined. Therefore, the data from 494 cities in FY 2011 was incorporated to this research. Similarly, 49 municipalities in FY 2014 did not provide access to their financial reports resulting in 497 cities being evaluated. As a result, 9.36% of CAFRs were not available for instant public viewing for FY 2011 versus 8.81% for FY 2014.

Figure 1. Availability of CAFRs for FY 2011 and FY 2014

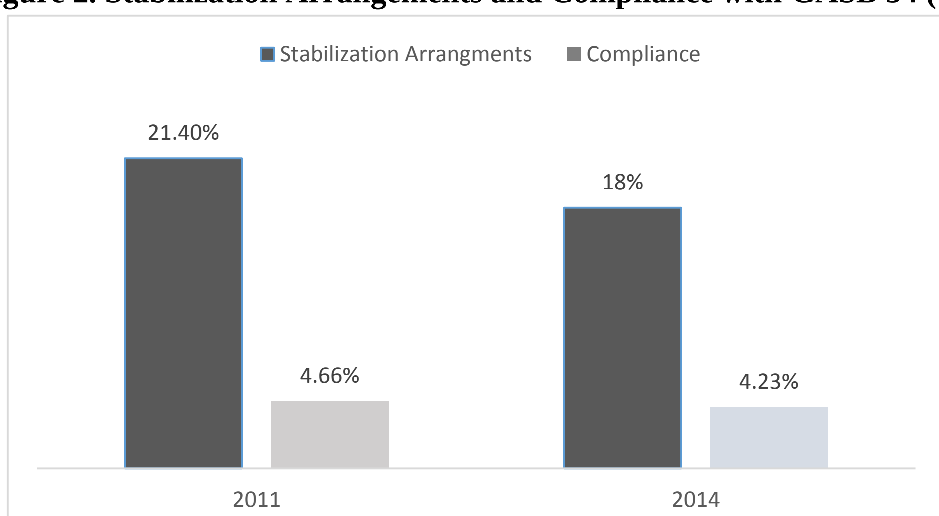


Further analysis revealed that 15 municipalities in FY 2011 presented their data in the pre-GASB 54 format: fund balance was distributed among reserved and unreserved sections in spite of nonspendable, restricted, committed, assigned and unassigned fund balance. This number represents 3% of all available CAFR reports in 2011 and is similar to Kelly's (2013) findings, where 10 out of 187 cities from FY 2011 had the same issue. As expected, all 497 cities adjusted their balance sheet in accordance to GASB №54 by FY 2014. Four cities did not have all five classifications of fund balance listed, but this practice is justified by Paragraph 5 (GASB, 2009a): "Some governments may not have policies or procedures that are comparable to those policies that underlie the classifications, and therefore would not report amounts in all possible fund balance classifications" (p.3).

One hundred and six (21.4%) CAFRs from FY 2011 mentioned the existence of stabilization arrangements, but only 23 of them provided required information on the authority that establishes it, requirements for adding to this amount, conditions for spending it, and the stabilization balance itself (GASB 54, 2009a). Therefore, only 4.66% of cities officially maintained stabilization arrangements and fulfilled GASB №54 requirements in FY 2011.

Even less reports mentioned stabilization provisions in FY 2014. Only 89 cities (18%) had stabilization arrangements, and 21 of them were in full compliance with Paragraph 26 (GASB, 2009a).

Figure 2. Stabilization Arrangements and Compliance with GASB 54 (% / Total)



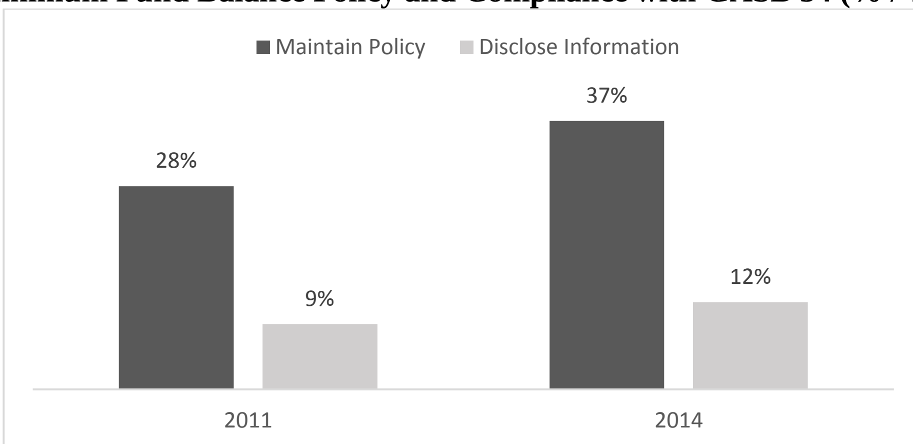
As demonstrated above, 4.23% of cities for this fiscal year mentioned their stabilization funds in CAFRs that satisfied the information disclosure requirement. However, if proportion is considered between the percentages of cities that mention stabilization arrangements and satisfied all parameters of Paragraph 26 (GASB 54), research shows a small improvement from 21.4% in 2011 to 23.6% in 2014.

The following evaluation demonstrates the largest progress between two fiscal years. It considers governments' compliance with the requirement to reveal (1) the highest level of decision-making authority and (2) formal action that creates or modifies commitment in committed fund balance, and (3) government bodies or officials who are legally authorized to assign funds for a specified purpose and (4) information on the laws and regulations that determine the process of authorization for assigned fund balance (GASB 54, 2009a).

Only 212 cities were able to properly disclose this information in FY 2011, whereas 417 complied with this requirement in FY 2014. Therefore, compliance levels grew from 43% to 84%. It is important to mention that the majority of the cities that did not meet this requirement in FY 2011 failed no more than two parameters out of four. For example, local governments would often be consistent in describing the highest level of authority and government bodies or officials that determine the distribution process for committed and assigned fund balance, but would disregard the rule to describe formal actions and policies that are involved in this process.

The last evaluation target concerned compliance with Paragraph 27 (GASB, 2009a) that requires a detailed description of government policy on minimum fund balance if such policy is being implemented. CAFRs from 138 cities in FY 2011 mentioned the existence of minimum fund balance policy primarily in the introductory section, but failed to disclose any information about it in the notes to the financial statements. Only 44 cities (32% or 9% of the total) provided details on this policy and specified the amount. One hundred and eighty-four CAFRs revealed the presence of minimum fund balance policies in the group of evaluated cities for FY 2014. Sixty-one (33%) reports conformed to GASB №54 and published necessary accompanying information in the notes, resulting in 12% of the total amount of reports containing detailed information about the minimum fund balance policy in FY 2014.

Figure 3. Minimum Fund Balance Policy and Compliance with GASB 54 (% / Total)



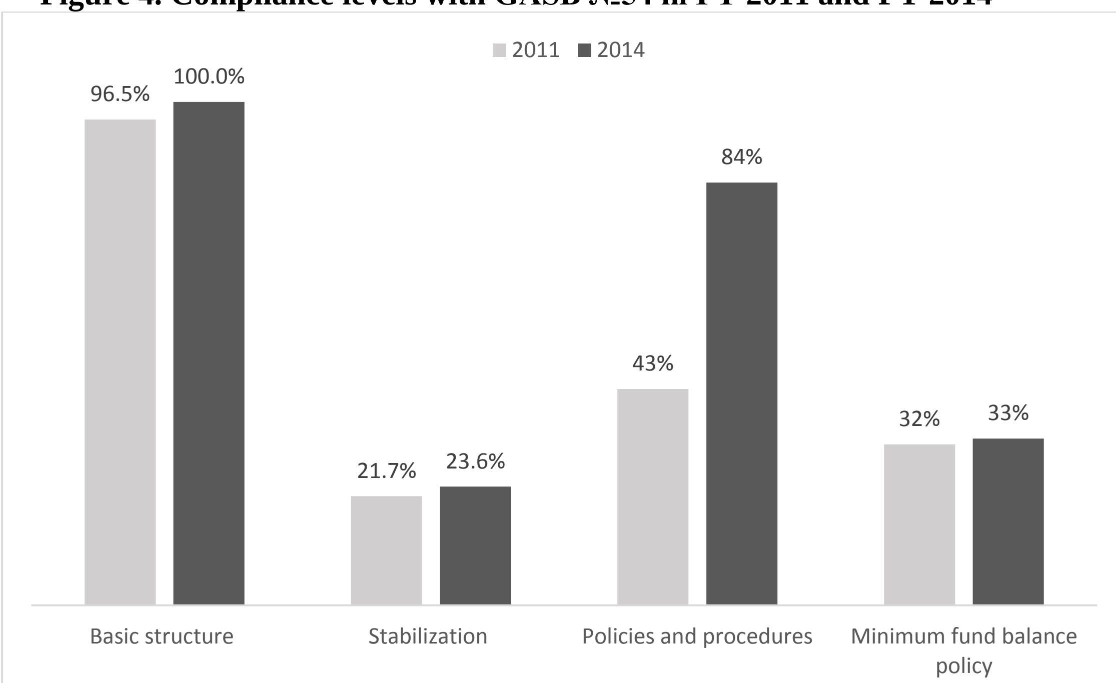
Analysis of 991 Comprehensive Annual Financial Reports from FY 2011 and FY 2014 demonstrate different improvement levels depending on the evaluation category. However, progress can be seen with maintaining basic structures, conforming stabilization arrangement requirements, revealing minimum fund balance policies and identifying government officials primarily responsible for key financial decisions and policies, and statutes that predetermine this process. Therefore, it can be concluded from the obtained qualitative data that the hypothesis of this research paper is upheld.

CHAPTER VI

CONCLUSION

Examination of Comprehensive Annual Financial Reports provides researchers, practitioners, legislators, financial managers and the public with a better understanding of the current level of compliance with GASB №54, its change over the years following implementation, sections where financial managers made the most improvement in reporting, and the most problematic areas that still need substantial review. Figure 4 demonstrates the summary of the research findings.

Figure 4. Compliance levels with GASB №54 in FY 2011 and FY 2014



Clearly, some governments demonstrated improvement in replying to the reporting concerns expressed by the users of pre-GASB №54 statements. Most recent reports reveal a reasonable level of information disclosure and provide a clear and descriptive information on the constraints that define hierarchy of new classifications, accounting policies and regulations that determine appropriation of funds for specific purposes and key figures in charge of such financial decisions. Despite 84% of CAFRs being in compliance with GASB №54 in FY 2014, 16% of the cities still need to revise their notes to the financial statements that concern the distribution of funds among new classifications.

This study highlights compliance problems with GASB №54. Despite clearly outlined standards of new accounting, some local governments continue to ignore new principles. Although compliance with stabilization arrangements demonstrated a small improvement from FY 2011 to FY 2014, majority of the cities still did not disclose the required information in the notes to the financial statements. Similarly, minimum fund balance polices were found being incorporated by local governments without required explanations and details in the notes to the financial statements.

These findings support the claim that current level of transparency in local governments have a large room for improvement. Low compliance proves that stabilization arrangements and minimum fund balance policies still remain a grey areas in government accounting. Taking the acquired data into consideration, it is vital to understand the reasons for why some local governments are still hesitant to release the required information in their financial reports. The review of the previous literature (see Stewart et al., 2013, and Rose & Smith, 2012) may suggest that there is a high chance that financial managers continue to recognize a political risk of disclosing this information and make efforts to avoid pressure from legislators, interest groups and taxpayers.

This research illustrates that fund balance in local government should continue to draw attention from the legislators and public in order to enhance transparency and improve accountability. The Governmental Accounting Standards Board should continue to educate local governments that are not in compliance with GASB 54 and clearly define consequences for non-compliance. Users of the reports should also exercise a high level of knowledge on the new regulations in order to control consistency of the reporting.

This research is limited to the evaluation of four specific compliance parameters, whereas GASB №54 establishes and clarifies much more than just basic structural arrangement of the balance sheet, fund balance distribution among new classifications, stabilization arrangement and minimum fund balance policy. For example, this statement also clarifies definitions of the general fund, the special revenue fund, the capital project fund, the debt services fund and the permanent fund, and adds new interpretations of the existing terms (GASB, 2009a).

Future research should focus on how these changes contributed to improving financial reporting. Researches should also consider surveying financial managers and users of Comprehensive Annual Financial Reports to assess their level of expertise on the use of GASB 54. This approach may help researches with gathering data to explain why compliance levels in some categories remain low. Further researchers should also consider developing and testing a model that explains the variation in compliance levels across cities.

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Appendix A

Table 2. Number of CAFRs considered per state

State:	№/cities:	State:	№/cities:	State:	№/cities:
Alabama	5	Louisiana	6	Ohio	18
Alaska	1	Maine	1	Oklahoma	7
Arizona	11	Maryland	3	Oregon	8
Arkansas	5	Massachusetts	12	Pennsylvania	8
California	125	Michigan	23	Rhode Island	9
Colorado	12	Minnesota	14	South Carolina	3
Connecticut	10	Mississippi	1	South Dakota	2
Delaware	1	Missouri	9	Tennessee	7
Florida	34	Montana	3	Texas	45
Georgia	9	Nebraska	2	Utah	9
Hawaii	1	Nevada	6	Vermont	0
Idaho	4	New Hampshire	1	Virginia	10
Illinois	24	New Jersey	13	Washington	14
Indiana	7	New Mexico	4	West Virginia	2
Iowa	9	New York	9	Wisconsin	12
Kansas	5	North Carolina	15	Wyoming	1
Kentucky	3	North Dakota	2		

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