



Governmental Accounting Standards Board  
of the Financial Accounting Foundation

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## Defining the Fundamental Elements of Financial Reporting

Recently, the Governmental Accounting Standards Board (GASB) completed its fourth Concepts Statement, *Elements of Financial Statements*, which defines the fundamental elements of financial statements, such as assets and liabilities.

Unlike GASB Statements, Concepts Statements do not establish accounting and financial reporting standards, but instead create a standards-setting framework built on interrelated objectives and fundamental concepts. The primary purpose of the framework is to guide the Board and help it to maintain a consistent approach from standard to standard. The Concepts Statements also may be a source of guidance to help the practitioners resolve issues that are not addressed in authoritative pronouncements.

### What Does the Concepts Statement Say?

Concept Statement 4 establishes definitions for seven basic elements of historically based financial statements of state and local governments. It defines the fundamental components of a *statement of financial position* (such as the governmental funds balance sheet) as follows:

- *Assets* are resources with present service capacity that the government presently controls.
- *Liabilities* are present obligations to sacrifice resources that the government has little or no discretion to avoid.
- A *deferred outflow of resources* is a consumption of net assets by the government that is applicable to a future reporting period.
- A *deferred inflow of resources* is an acquisition of net assets by the government that is applicable to a future reporting period.
- *Net position* is the residual of all other elements presented in a statement of financial position.

The elements of a *statement of resource flows* (such as the government-wide statement of activities) are defined as follows:

- An *outflow of resources* is a consumption of net assets by the government that is applicable to the reporting period.
- An *inflow of resources* is an acquisition of net assets by the government that is applicable to the reporting period.

## Plowing New Ground

Other standards-setters, including the Financial Accounting Standards Board (FASB), the GASB's sister organization for private corporations and not-for-profit organizations, and the International Accounting Standards Board (IASB), have also developed definitions of the elements of financial statements. Those organizations are currently working together to update and harmonize their conceptual frameworks. The Federal Accounting Standards Advisory Board (the FASAB, which establishes accounting standards for the United States federal government) also is currently finalizing its definitions. The GASB's framework takes into account the state and local government environment in at least two primary ways.

***Independent Definitions.*** The GASB developed definitions of the individual elements that are independent of each other as much as possible. While it is common to build the definitions of financial statement elements based on the definition of a particular element or elements, the GASB took a different path because it did not believe that any particular element (for example, asset or liability) should be seen as more important than another (for example, an inflow or outflow of resources).

Under the approach other standards setters have used, for example, a revenue would typically be defined as an inflow of or increase in assets or the settlement of a liability, and an expense would be viewed as an outflow or using up of assets or the incurring of a liability. Therefore, to understand what revenues and expenses are, you must first understand what assets and liabilities are. Given the importance of the resource flows statements in the state and local government environment and the importance of the interperiod equity concept, the independent definition approach was considered by the GASB to be more appropriate.

In order to craft independent definitions, the GASB began first by defining the nature of a *resource*—a concept that is central to the definitions and incorporated within them.

***Separate Treatment of Deferrals.*** Deferrals generally have not been defined separately, leaving many to wonder just what they are and why they appear with the assets and liabilities in a statement of financial position when they often do not bear the characteristics of either. Again, because of the importance of the interperiod equity concept, the GASB concluded that deferrals should be defined as separate elements.

Deferrals might be looked at as future revenues and expenses waiting until required conditions have been met or a particular point of time has been reached to be reported.

## Why Not Just Adopt the Existing Definitions?

A primary difference between private companies and governments is that the latter do not exist to generate profit. Rather, governments exist to provide services to

their constituents. The notion of the capacity to provide service is already embodied in standards such as GASB Statement 42 on the impairment of capital assets. Whereas private sector standards consider an asset impaired when its ability to generate cash flows is reduced, the GASB's standards identify impairment as a loss of service capacity. Until now, this fundamental philosophy has not yet been officially expressed in the GASB's conceptual framework. By sharing the idea of a resource, the definitions incorporate service capacity as an essential facet.

In developing these definitions, the GASB did benefit, however, from the work of other standards setters. The GASB closely considered the concepts of the FASB, IASB, FASAB, the International Public Sector Accounting Standards Board, and others. Certain portions of the definitions are, in fact, quite similar.

### **Incorporating Feedback**

Gathering, evaluating, and incorporating comments and feedback from constituents regarding GASB proposals is a critical part of due process. In response to comments that the differences between the terms *resource* and *future resource* were not clearly articulated in the proposed version, the Board changed the way *resource* is used in the final Concepts Statement. In order to increase clarity, it is now used in its general dictionary meaning to refer to a supply or other means that can be drawn upon when needed.

The term *net assets* was replaced with *net position*, because *net assets* was interpreted by some readers as relating to the economic resources measurement focus in particular, rather than as a general term. The Board also amended Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, to conform the paragraph describing the elements presented in financial statements with the language of this Concepts Statement.

- [Order Concepts Statement 4](#)
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