The GASB as a Contentious Accountability and Governance System in US Local Government

By Daniel Masterson & Professor Ken Smith

ABSTRACT

The Governmental Accounting Standards Board (GASB) has sought to expand its standards setting into new areas of accountability reporting, including performance reporting. However, some of these standards have not been widely implemented. This article seeks to understand the contentious nature of accountability reporting areas through an application of accountability and voluntary club theories. We find that the different intended uses of accounting information, the complex nature of the accountability concept and the divergence of views of the objectives of accounting contribute to the dispute over public reporting in the US. These diverging views are especially consequential due to the voluntary, or club-like, nature of the U.S. public sector accounting system.

INTRODUCTION

The priorities of public governance and the accountability movement (e.g. transparency, openness, public participation, responsiveness, creating value, etc.) depend on reliable information and an effective means of communication. The appeal of accounting as a tool to improve information for these purposes is strong (Trueblood Committee 1973). Accounting can create consistency in measurement and presentation as well as highlight the costs and benefits of governmental activities (K. Smith and Schiffel 2006). Accounting standards are intended to further improve the reliability and credibility of information (Governmental

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Accounting Standards Board 1987). But efforts to apply accounting standards to new areas of public accounting, including performance reporting, have been vigorously contested and not widely implemented (McCall 2009, 1).

This article begins with an overview of public sector accounting standards and their uses in the United States. The body of the article consists of two parts. The first part describes the perspective of those who support a more expanded role for accounting in public governance and accountability, drawing on public administration accountability theory. The second part describes the view of those who prefer a more limited role and discusses implications of accountability club theory for voluntary accounting standards systems. The final section discusses the findings of our analysis and directions for future research.  

**ACCOUNTING STANDARDS IN THE PUBLIC SECTOR**

Public sector accounting standards are often created by independent, non-governmental organizations that aim to serve the public interest rather than the political or economic goals of a particular government, political party, or interest group. The independence of standards setters helps ensure that standardized information is useful for resolving problems resulting from the principal-agent relationship between a government and its citizens (as well as their chosen representatives). In systems with dispersed governmental authority, like the numerous state and local governments within the United States, accounting standards can provide consistency and comparability across reporting governments, thereby increasing the usefulness of all reports.

The Governmental Accounting Standards Board (GASB), which creates state and local government accounting standards in the United States, has embraced the public governance and accountability movement (GASB 1994; GASB 2006). The GASB is an independent, not-for-profit organization that sets accounting and financial reporting standards for state and local governments and governmental not-for-profit organizations (e.g., public

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1 This article was inspired by a research project on the scope of the GASB. The views expressed are those of the authors and not of the GASB or the Financial Accounting Foundation (2011).
colleges, universities and government hospitals) in the United States. To provide transparency in their own activities, the GASB uses a conceptual framework and a clearly defined due process to guide standards development. Consistent with Public Governance principles, the GASB’s conceptual framework focuses on providing information that is *useful* for decision-making and accountability purposes (Governmental Accounting Standards Board 1987). There is relatively little disagreement over the GASB standards created for financial uses\(^2\). However, GASB’s constituents are divided over accounting standards created for accountability and other public uses\(^3\). Consequently, the GASB’s standards and guidance in these areas have not been widely implemented.

The GASB was created in 1984 after extensive negotiations by representatives of nineteen organizations, most of them non-governmental professional associations. The GASB was a solution to political pressure for state and local government financial reform and was an alternative to governmental standards setting by the Financial Accounting Standards Board (FASB), an organization that already oversaw standards setting for private-sector financial reports (Chan 1985, 5-11). Although the GASB was created to respond specifically to the unique environment of public sector reporting, it largely retained the private sector conceptual framework with its focus on user-needs and decision-useful information\(^4\).

GASB constituents have publicly disputed the scope of topics for which it should set standards (Government Finance Officers Association, n.d.). These controversial topics include: 1) Other Post-Employment Benefits, 2) Infrastructure Reporting, 3) Financial Projections, and 4) Service Efforts and Accomplishments. The dispute is partly driven by scepticism of the GASB’s capacity—as a *financial* accounting organization—to adequately

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\(^2\) FINANCIAL USE – any usage of information leading to a financial transaction. Typical users include the budget staff, bond market, agency management and business community.

\(^3\) PUBLIC USE – any usage of information about an organization. Typical users include the media, political parties/politicians, taxpayers, and interest groups. A common use is “accountability”, which is discussed in greater detail later.

\(^4\) GASB’s vision identifies “accountability and well-informed decision-making” as primary purposes of its standards. Its mission is to create standards that result in useful information for users of financial reports and that guide and educate relevant constituents (Governmental Accounting Standards Board).
address accounting and reporting issues for public uses of information. However, our analysis suggests the dispute stems from a genuine disagreement about the appropriateness of standardization for certain topics of information and the objectives of public sector accounting standards--areas of GASB governance that were never fully resolved during its formation (Chan 1985, 28; Wallace 1985, 71-75).

Sam McCall identifies two diverging but prevailing frames of reference as the cause of this divide: the expanded view and constrained view (McCall 2009, 10). The expanded view is held by the GASB and serves as the foundation for its conceptual framework and many of its accounting standards. The constrained view describes the opponents’ perspective that the GASB should not create standards intended for public accountability uses.

We propose that the views are based on two diverging value systems. The expanded view--which focuses on providing information that is useful to those who need it and have no other means of acquiring it--gives preference to individual users at the potential expense of society as a whole. The constrained view is founded on a macro perspective of all information producers and users and gives preference to the costs of producing and processing information at the potential expense of individual users.

**PART 1: EXPANDED VIEW: THE USEFULNESS OF ACCOUNTING STANDARDS**

We propose that the first view considers useful information to be the primary--if not sole--objective of accounting standards (Coy, Fischer, and Gordon 2001; Heslop and van Staden 2004; Jones 1992; Rutherford 1992, 266). This view can be modelled using agency theory with the principals (voters and creditors) as information users and the agents (the government and its elected and appointed officials) as information preparers (Zimmerman 1977). From this perspective, it follows that accounting tools should be evaluated based on the degree to which they serve a principal’s needs.

The usefulness view can also be modelled from an ethical perspective where the government has a moral obligation to share information with its citizens and taxpayers. GASB asserts in Concepts Statement No. 1 (1987) that citizens have a “right to know” how their government performs. In a similar vein, Behn argues that democratic institutions have an obligation of “fairness” which suggests that principals deserve improved access to information provided by accounting standards, especially when the principal lacks other
means to acquire information to evaluate an agent’s performance (Behn 2001).

Prior research on the uses and users of government accounting information suggests a wide range of interested individuals and groups (Cheng 1992; Cheng 1994; Drebin 1981). Table 1 below lists some of the more prominent uses of accounting information and places them in two broad categories: financial uses and public uses.

**Table 1: Accounting Usefulness and Importance for Different Uses**

<table>
<thead>
<tr>
<th>Uses</th>
<th>Is Accounting Information Potentially Useful?</th>
<th>Relative Usefulness of Accounting Compared to Other Information Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Uses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditor Decisions</td>
<td>yes</td>
<td>Primary Source</td>
</tr>
<tr>
<td>Budget Making</td>
<td>yes</td>
<td>Supporting Source</td>
</tr>
<tr>
<td>Union Decision</td>
<td>yes</td>
<td>Supporting Source</td>
</tr>
<tr>
<td>Management Decisions</td>
<td>yes</td>
<td>Supporting Source</td>
</tr>
<tr>
<td>Business Relocation</td>
<td>yes</td>
<td>Supporting Source</td>
</tr>
<tr>
<td>Public Uses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Voting</td>
<td>yes</td>
<td>Supporting Source</td>
</tr>
<tr>
<td>Media/Analyst Supported Accountability</td>
<td>yes</td>
<td>Supporting Source</td>
</tr>
<tr>
<td>Political Squabbles</td>
<td>yes</td>
<td>Supporting Source</td>
</tr>
<tr>
<td>Interest Groups</td>
<td>yes</td>
<td>Supporting Source</td>
</tr>
<tr>
<td>Improvement</td>
<td>yes</td>
<td>Primary Source</td>
</tr>
</tbody>
</table>

Perhaps the most common use of accounting information is for credit decisions. A typical debt instrument will be sold to parties outside the government with various entities assisting on both the “sell” side (e.g. bond-rating agencies, insurance, bond counsel, underwriters, auditors, etc.) and “buy” side (e.g. analysts, media, institutional investors, insurance companies, etc.). The financial reporting model developed by the GASB includes a Comprehensive Annual Financial Report (CAFR) with Management Discussion & Analysis (MD&A), numerous schedules, statements and footnotes. CAFR’s are often 200 or more
The internal users of accounting information—the elected and appointed leaders of a governmental entity—use accounting information for financial decisions as well as other public uses. These uses include assessing accountability in terms of stewardship of public resources and the effectiveness of serviced delivery, making decisions about the allocation of resources through the budget process, and guiding the improvement of government operations (Jones 1992; Moynihan 2008, 3-5).

The proposed external users of accounting information usually include voters who would use accounting information to make political accountability decisions. Evidence suggests that few citizens currently use accounting information directly for these kinds of decisions (Rutherford 1992, 269). However, it may be the case that citizens use accounting information indirectly through media or other third-party analysts (Schiffel and Smith 2006).

**ACCOUNTABILITY USES**

Public sector accounting standards are intended to provide information that is useful for accountability. Although accountability is normatively desirable, it is an ambiguous concept with unclear boundaries. Scholars of accountability point out that it can have multiple meanings. It has been described as a mechanism, a relationship, a process and—as implied by accounting standards setters—a use of information (Behn 2001; Governmental Accounting Standards Board 1987; Kelly 2008; Koppell 2005, 95-99; Romzek 2000; Rutherford 1992; Sinclair 1995). But what does it mean for information to be useful for accountability?

Accountability is usually associated with principal-agent relationships. Principals hold agents accountable for meeting agreed upon obligations. But, because of information asymmetry, a principal can never fully monitor the efforts of an agent. Standards for accounting information useful for accountability would presumably improve the quality of information available to principals and improve their capacity to hold agents accountable. As scholars point out, holding an agent accountable can mean different things to different people, making a consistent model of accountability use problematic.

In response to this problem, we create a framework for classifying accountability uses based on Koppel’s five dimensions of accountability (Figure A). Koppell defines the five notions as *Transparency*: Did the organization reveal the facts of its performance? *Liability*:
Did the organization face consequences for its performance?  *Controllability:* Did the organization do what the principal desired?  *Responsibility:* Did the organization follow the rules?  *Responsiveness:* Did the organization fulfill the substantive expectation (demand/need)?

In our model, the five dimensions are arranged into three distinct phases in a sequential public accountability assessment process that informs accountability decisions. The first phase of the process—transparency—is an assessment of whether a government has revealed the facts in its reporting.

The second phase consists of three different, potentially conflicting assessments of an agent’s performance. Whether an agent has been *responsible* depends on whether they have followed the rules, laws or professional norms that govern their behaviour. A *responsibility* assessment is made based on explicit and previously codified expectations of behaviour. A *controllability* assessment determines whether or not an agent fulfilled the explicitly and previously identified objective determined by a principal. This concept can be thought of as obedience to orders (Finer 1941; Koppell 2005, 97). The third assessment, *responsiveness*, determines the extent to which an agent has fulfilled a demand or need as it manifests. A key element of responsiveness is recognition and fulfilment of the demand or need by the agent without explicit identification by a principal or other authority. Responsiveness implies innovation to satisfy customers in a competitive marketplace.

The third phase in the accountability process is liability. Principals assess whether an agent faced appropriate consequences based on its performance assessments. Principals decide in this final phase whether and how to apply positive or negative consequences to an agent, or make other decisions, in response to the assessment(s).

We propose the three accountability assessment phases roughly illustrate how accounting information is used for accountability purposes. It is noteworthy that this model of accountability is not limited to one aspect of government performance. Because some public users are interested in nearly every aspect of government performance, this model does not appear to create a topical boundary for accountability use based on a usefulness criterion.
PART 2: CONSTRAINED VIEW: SOCIETAL VALUE/BENEFIT

The constrained view is based on a value system that sees the ultimate objective of accounting standards setters as the maximization of value to society. Implied in this view is that the usefulness of information reflects only one of the potential benefits of accounting standards, while disregarding the costs that are imposed. Asserting that reliable estimates of the net societal value created by public sector accounting standards should be incorporated into standards-setting is clearly much easier than actually doing it. However, techniques such

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5 In our discussion, societal value and net societal value are the net value of all direct and indirect benefits and costs resulting from an accounting standard or category of standards at a system-wide level for all preparers, users and other members of the community.
as *Social Return on Investment* and *Benefit-Cost Analysis* show that governments, as well as private companies, are developing tools to quantify the impact of their activities in order to shape policy. It may not be possible to fully monetize the impact of public sector accounting standards, but even rough estimates of both the benefits that standards create and the costs that they impose would likely help standards setters better serve the public interest. Additionally, such estimates could steer future empirical work and over time provide increasingly stronger evidence of how public value is created by accounting standards.

**ELEMENTS OF SOCIETAL VALUE**

In this section we briefly discuss the factors that contribute to societal value and develop a general framework for analysis of the societal value created by accounting standards. Our basic model of societal value aggregates the proposed benefits of accounting standards with the costs (Table 2). We propose that accounting standards produce benefits to society through the improvements they induce (Behn 2003; Jagalla, Becker, and Weber 2011). This improvement could be in one of six dimensions: government efficiency, government effectiveness, information economy (usefulness), societal equity, social/community, and network. We categorize the potential costs of accounting standards as: direct production costs, information consumption (use) and processing costs, unintended consequences, and system transaction/standards design.

<table>
<thead>
<tr>
<th>Proposed Benefit Dimensions</th>
<th>Potential Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Efficiency</td>
<td>Production</td>
</tr>
<tr>
<td>Government Effectiveness</td>
<td>Information Consumption and Processing</td>
</tr>
<tr>
<td>Information Economy (Usefulness)</td>
<td>Unintended Consequences</td>
</tr>
<tr>
<td>Societal Equity</td>
<td>System Transactions/Standards Design</td>
</tr>
<tr>
<td>Social/Community</td>
<td></td>
</tr>
<tr>
<td>Network</td>
<td></td>
</tr>
</tbody>
</table>
ACCOUNTABILITY COSTS

Figure A (described in the previous section) helps illustrate potential costs of accounting standards intended for public accountability uses, especially the potential for unintended consequences. The three accountability assessments in the second phase of the process are the source of what is known as multiple accountabilities disorder (MAD) (Kelly 2008; Koppell 2005, 99). MAD describes the phenomenon of multiple conflicting accountability expectations and how this can contribute to organizational dysfunction and unintended consequences. MAD stems from the fact that an agent’s responsibility, controllability and responsiveness are often in conflict.

The aftermath of Hurricane Katrina in New Orleans illustrates this accountability conflict. While many federal agencies spent the days after the hurricane following rules and waiting for orders, the Coast Guard began rescue operations in response to problems it observed. While federal agencies such as FEMA were responsible and controlled, the Coast Guard was responsive to the real demands and needs of the situation, potentially disregarding rules and orders in the process (Horwitz 2009). Both FEMA and the Coast Guard were accountable, but in different and conflicting dimensions.

What does this model of public accountability imply for accounting standards setters committed to supporting accountability? Accounting standards may contribute to conflicting expectations and incentives within governments. This is because accounting standards—when adhered to responsibly by reporting governments—may create incentives that conflict with a government’s controllability or responsiveness. This suggests that although accounting standards may provide societal benefits in the form of better information for accountability assessments, they may also impose costs in the form of conflicting expectations and organizational dysfunction.

LEVELS OF ACCOUNTING STANDARDS VALUE ANALYSIS

Figure B shows societal value as the aggregate of all costs and benefits that result from accounting standards, including direct costs of production as well as hidden externalities. In
our model, the benefits and costs of accounting standards accrue at three different levels throughout the system: individual users, reporting jurisdictions, and system-wide.

At the first level, individual users benefit from standardized information that is useful for their needs, whether those needs are related to public accountability, internal organizational decision-making or financial market decisions. These individual users will derive value from standardized information to the extent that it is useful and that the costs of consumption do not exceed the benefits. Consumption costs, such as poor understandability, inaccessibility and other individual level transaction costs are relevant because--if sufficiently high--they can prevent a potential user from using accounting standards.

Governments and their constituents or jurisdictions make up the second level of our public value analysis framework. The benefits of accounting standards accrue to jurisdictions in three general ways: 1) lower cost or improved access to government debt through bond market participation; 2) improved accountability of government to its constituents; and 3) improved operational performance of government (Baber and Gore 2008; Behn 2001; Benson, Marks, and Raman 1991; Governmental Accounting Standards Board 1987). It is important to note that these three benefits may result from a particular accounting standard whether they are intended purposes or not. As we discuss below, this is also the case for the costs of standards.

The costs of accounting standards include their impact on the direct costs of accounting, report production, and auditing, as well as indirect costs. Indirect costs can be thought of as unintended consequences or externalities and have been studied and documented extensively by scholars (see Ridgway (1956) for an early example). They include political, financial and legal risk, manipulation of accounting, gaming, misaligned incentives, changes in organizational behaviour, and decreased levels of performance (Behn 2001; Buthe 2009; Harris 1995; Moynihan 2008; Radin 2006; P. Smith 1995).

Accounting and reporting standards likely limit local discretion, providing the benefit of consistency and comparability with a trade-off in local autonomy. This loss of autonomy can introduce new dimensions of accountability that may conflict with local priorities (Koppell 2005, 99). One notable risk related to operational performance is known as the performance paradox (van Thiel 2002). The paradox is due to performance measurement use actually causing deterioration of the operational performance of the measured activity.

The third level of analysis is the entire system of reporting governments for which standards are designed and intended, whether the governments use the standards or not. The
benefits and costs of accounting standards for all individual users and constituent jurisdictions contribute to the net public value of the system. In addition, the cost of designing and developing standards and other system-wide transaction costs would likely be higher for systems applying a conceptual framework focused on societal value than for systems applying a framework focused on usefulness.

Figure B: Levels of Accounting Standard Benefits and Costs

ADOPTION RATE IMPACT ON PUBLIC VALUE

An important dimension of net societal value at the system-wide level is the adoption rate among governments within the system. Part of the value of accounting standards comes from their usefulness in making comparisons between governments (GASB 1994). Therefore, ceteris paribus, the value of accounting standards will be greater when more governments adopt them. This implies that the costs and benefits of those individuals who make decisions on behalf of governments about accounting standards adoption are also worth considering. We draw on economic club theory to further explore this concept.
Clubs are organizations that provide non-rivalrous but excludable goods, or “club goods”, to members (Buchanan 1965, 1-3; Cornes and Sandler 1996). The theory has subsequently been adapted to specific contexts and two of these adaptations—voluntary clubs and accountability clubs—provide some useful insights for voluntary public sector reporting standards systems (Gugerty and Prakash 2010; Potoski and Prakash 2009; Prakash and Potoski 2007). Rather than existing solely to provide club goods for members, voluntary and accountability clubs seek to “produce positive social externalities beyond what government regulations require” (Prakash and Potoski 2007, 776).

Accounting standards organizations resemble voluntary and accountability clubs because their standards are designed to produce a public good⁶ that would not otherwise be produced. Accounting standards organizations also monitor and enforce the use of their standards through auditing and incentive mechanisms that demonstrate to stakeholders of government accounting that they are committed to preventing “member” governments from shirking the responsibilities of membership (Buthe 2009, 158).

Successful clubs must balance stakeholder expectations of strong monitoring and enforcement mechanisms with club member expectations that club standards will not tighten excessively after members have joined, opportunistically exploiting the fact that exiting the program might be costly (Prakash and Potoski 2007, 784). Compliance with club standards might require investments in infrastructure, technology or competency assets that may not otherwise be made and are difficult to apply to alternative uses (Williamson 1985). These sunk costs and exit costs will discourage members from leaving clubs up to a point. However, changes to a club’s standards could push members to exit if they require additional investments or costs that outweigh the costs of exiting and the benefits of club membership.

Accounting standards setters’ “club” design and operating policy must balance the stringency of standards with the level of adoption in order to maximize societal value. Accounting standard setters may prefer stringent standards to enhance the club’s credibility with members’ stakeholders. However, such standards may lead to low membership—and

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⁶ Since the benefits provided by public sector accounting standards are non-rival and non-excludable, use by one individual does not limit use by another and individuals cannot be kept from benefiting from club membership. As such, they can be thought of as “public goods” (Buthe 2009; Mayston 1992).
smaller network effects and scale economies in creating club goods—as fewer potential members choose to meet demanding membership requirements (Prakash and Potoski 2007, 788). Whereas, lenient standards clubs could be expected to attract a large roster, they may instead attract fewer members simply because they cannot generate a sufficiently valuable brand or other benefits (Prakash and Potoski 2007, 781).

Club theory tells us that some policy contexts have higher levels of heterogeneity in the pool of potential club members and that in these policy contexts, multiple different voluntary club types will produce more desirable outcomes than a one-type-fits-all club. (Prakash and Potoski 2007, 788). Because following accounting standards may be a good idea for one community and a bad idea for another community, a standard-setting organization must make trade-offs in its choice of scope or activities. The GASB’s ability to credibly manage the benefits and costs to club members and set appropriate policy goals, while retaining the trust of the intended users of government reports, could directly impact their legitimacy, support and the public value they create.

**DISCUSSION, FINDINGS AND FUTURE RESEARCH**

The purpose of this article was to seek explanations for why accountability reporting has not been widely supported or adopted among state and local governments in the United States. In addition, accountability focused accounting standards initiatives continue to be hotly contested, such as the GASB’s preliminary views on Financial Projections issued in November 2011. The dispute over the GASB’s proposed accounting standards intended for public uses may be the result of multiple factors. Our analysis suggests a significant factor is disagreement over the objectives of accounting standards. Those who support the decision usefulness criterion, and the expanded accounting standards that it produces, believe that accounting standards should induce governments to report better information because of the overriding ethical obligation of governments and other large organizations to provide powerless users with accurate information about their activities. Those who feel that accounting standards in non-traditional areas are inappropriate seem to view the objective of accounting standards as the increase in societal value by producing standards with benefits to society that clearly outweigh the costs.
In addition to clarification of these two diverging views, we have four main findings. First, there are multiple “uses” of accounting information--such as financial, public and internal, and current accounting standard setting does not identify or explore all of the unique features of these categories. Second, the concept of accountability is used rather differently by Public Administration scholars than accounting standard setters. Public Administration scholars describe multiple dimensions of accountability that are complex and in conflict with each other, while accounting standard setters take a more simplistic and benign view. Third, the costs of developing and implementing accounting standards are given limited attention by standard setters but are central to the opponents’ view. Finally, club theory suggests that the costs of accounting standards are relevant to club leaders--in this case the standard setting body--and that the relatively low level of adoption for accountability focused standards is consistent with club theory’s predictions when clubs impose high compliance costs. This implies that the normative argument in favour of accountability reporting does not appear to overcome the reality of system-wide costs or the risks faced by the GASB due to its “voluntary club” characteristics.

Future academic research could further explore the dimensions of accountability and their implications for accounting standard setting by testing the relationships outlined in Figure A, especially the interaction between the performance assessment dimensions and their potential to produce unintended and dysfunctional consequences. Also, we encourage development of tools for measuring all costs and benefits produced by accounting standards and accruing at the three levels we discuss: individual, organizational and societal.

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