

# Consideration of Display Standardization in Government Accounting

Kohei Miyamoto

## 1. Introduction

This paper aims to examine the appropriate display format for standardization by focusing on several display standards in Japanese government accounting. In Japan, there are several formats of financial statement in governmental accounting. For example, Ministry of Internal Affairs and Communications (MIAC) Basic model [2006], MIAC Revision model [2006], and Tokyo model [2007]. Because structure of accounting and display format of financial statements differ, it might be difficult to understand for information users. In such cases, it restricts an appropriate decision-making.

On the other hand, corporate accounting is more progressive than governmental accounting through institutional design and theory verification based on social and economic situation. Moreover, there are many experts with knowledge of corporate accounting, for example Certified Public Accountants, Tax Counselor and so on. So standardization with corporate accounting should be aimed to establish new government accounting system.

Therefore, in this paper, the method of consideration is revealed in Section2. Then, raise the “Question” for government accounting standards in financial statement display at Section3 and 4. Thereafter in Section5, set the hypothesis of this study for the sake of solving problem. And finally in Section6, verify the hypothesis by deductive consideration to derive conclusions.

## 2. The Method and Procedure of Consideration

In this section, the method and procedure of this study is shown. At first, the method of introducing hypothesis is clarified. Then next, the procedure of verifying hypothesis and deriving conclusion is explained.

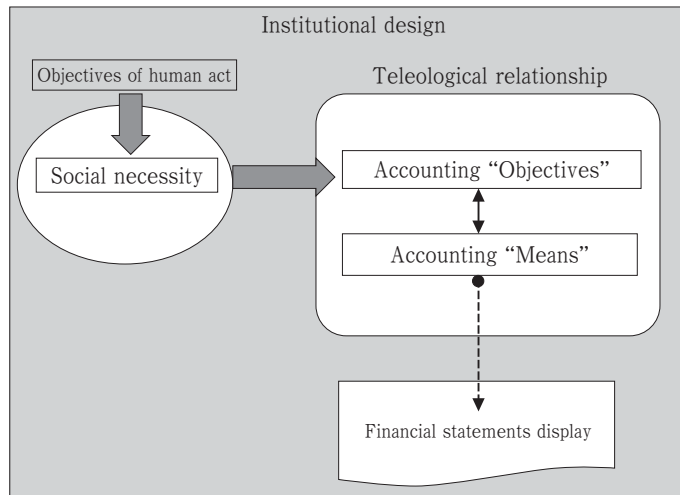
### 2-1. Method of Consideration Based on “Teleological Relationship Theory”

“Teleological relationship theory” is one of the concepts on social science. It is the aspect of the relationship between objectives and means. And this concept provides a view of “Social necessity<sup>1)</sup>”. As a procedure, accounting objectives are set due to the “Social necessity”, and then the means is formed to achieve these objectives. Here, the means is displaying financial statements. It is possible to fulfill social necessity of accounting by display.

Because institutional design depends on objectives of human act, so it is feasible to establish the accounting system in the view of teleological relationship theory. And thereafter, we can raise the “Question” caused by the lack of social necessity.

As shown in figure-1, “Objectives” of accounting is set to meet the social necessity, and financial statement is “Means” to achieve the objectives. Therefore, if display on financial statement (this imply the means) does not achieve the objectives, it cannot fulfill the social necessity. Then the “Question” is manifested in these unsatisfied situations.

Figure 1 - Conceptual Diagram of “Teleological relationship”



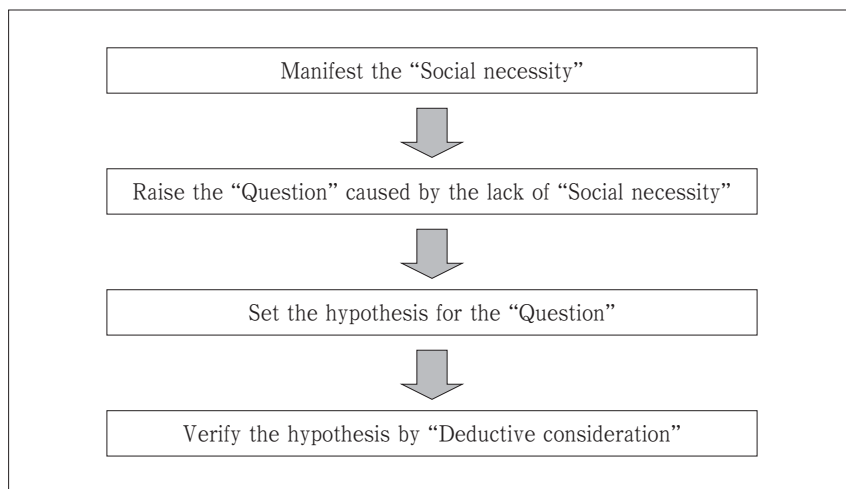
### 2-2. Procedure of Consideration Based on “Normative- deductive” Study

This study aims theoretical considerations of display unification for governmental accounting, based on prevailing theory of corporate and government accounting. As an ordinary method of accounting research, a hypothesis containing “Ought” is set. And in such research,

“Normative-deductive”<sup>2)</sup> consideration by prevailing accounting theory may be appropriate to reach a final conclusion.

Therefore, the hypothesis for the sake of solving the “Question” is set in this study. Then verify the hypothesis in order to draw conclusion by deductive consideration based on prevailing theory and/or criteria. Thereafter, display format at financial statements to meet the social necessity is set. By the above, procedure of study is summarized in the following figure2.

Figure 2 - Procedure of Study



### 3. Manifestation of the “Social necessity”

As described above, “Social necessity” can be manifested by application of the teleological relationship theory. And then, we can raise the “Question” in accounting institutional design in case there does not meet the necessity. In this section, “Objectives” of International Public Sector Accounting Standards Board (IPSASB), Governmental Accounting Standards Board (GASB), Federal Accounting Standards Advisory Board (FASAB) are explained. Thereafter the “Social necessity” is manifested.

#### 3-1. “Objectives” in Government Accounting

##### 3-1-1. IPSASB [2006]

IPSASB indicaverifythat the objectives of general purpose financial statements are to

provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making and evaluating decisions about the allocation of resources (par.15). Specifically, financial reporting in the public sector should be to provide information useful for decision making, and to demonstrate the accountability of the entity for the resources entrusted to it (par.15). That information is as follows;

- (a) Providing information about the sources, allocation, and uses of financial resources
- (b) Providing information about how the entity financed its activities and met its cash requirements
- (c) Providing information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and commitments
- (d) Providing information about the financial condition of the entity and changes in it
- (e) Providing aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency, and accomplishments

And general purpose financial statements can have a predictive or prospective role, providing information useful in predicting the level of resources required for continued operations, the resources that may be generated by continued operations, and the associated risks and uncertainties (par.16). Financial reporting may provide users with information of indicating whether resources were obtained and used in accordance with the legally adopted budget (par.16).

### **3-1-2. GASB [1987]**

In the United States early, conceptual framework of government accounting is defined. And accounting standards based on this framework is set. In 1987, Concepts Statement No. 1 was issued in GASB, objectives of government accounting have been revealed. The main contents of the provisions are as follows;

- (a) Accountability is the cornerstone of all financial reporting in government. (par.56)
- (b) Accountability requires governments to answer to the citizenry—to justify the raising of public resources and the purposes for which they are used. (par.56)
- (c) The intent of these laws is to require financing and spending practices that enable governmental entities to avoid financial difficulty and to —live within their means. (par.59)
- (d) The current generation of citizens should not be able to shift the burden of paying for

current-year services to future-year taxpayers. (par.60)

- (e) Financial reporting should help users assess whether current -year revenues are sufficient to pay for the services provided that year and whether future taxpayers will be required to assume burdens for services previously provided. (par.61)

In this case, upon which was defined as “resident” the primary information user, “accountability” is the cornerstone of all financial reporting in government. Furthermore, GASB believes that “Interperiod Equity” is a significant part of accountability and is fundamental to public administration (par.61). Namely “Interperiod Equity” is a concept to help users assess whether current year revenues are sufficient to pay for the services and whether or not future taxpayers will be required to assume burdens for services previously provided.

### **3-1-3. FASAB [1993]**

On the other hand, FASAB Concepts Statement No. 1 was issued and indicated objectives of governmental accounting in that. It is said that accounting demonstrates its accountability to internal and external users of federal financial reports, provide useful information to internal and external users (par.3). As indicated below, four objectives are set, “Budgetary Integrity”, “Operating Performance”, “Stewardship”, and “Systems and Controls”.

#### **(1) Budgetary Integrity**

FASAB describes that financial reporting should assist in fulfilling the government’s duty to be publicly accountable for monies raised through taxes and other means and for their expenditure (par.13). And FASAB indicaverifyhat financial reporting should provide accounting information that helps the reader to determine (1) how budgetary resources have been obtained and used and whether their acquisition and use were in accordance with the legal authorization, (2) the status of budgetary resources (par.13).

#### **(2) Operating Performance**

FASAB explains that financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity, the manner in which these efforts and accomplishments have been financed, and the management of the entity’s assets and liabilities (par.14). And furthermore, FASAB indicaverifyhat financial reporting should provide

information that helps the reader to determine (1) the costs of providing specific programs and activities and the composition of , and changes in, these costs, (2) the efforts and accomplishments associated with programs and the changes over time and in relation to costs, and (3) the efficiency and effectiveness of the government's management of its assets and liabilities (par.14).

### **(3) Stewardship**

FASAB explains that financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how the government's financial conditions have changed and may change in the future (par.15). And furthermore, FASAB indicates that financial reporting should provide information that helps the reader to determine whether (1) the government's financial position improved or deteriorated over the period, (2) future budgetary resources will likely be sufficient to sustain public services and to meet obligations, and (3) government operations have contributed to the nation's current and future well-being (par.16).

### **(4) Systems and Controls**

Federal financial reporting should assist report users in understanding whether financial management systems and internal accounting and administrative controls are adequate to ensure that (1) transactions are executed in accordance with budgetary and financial laws and other requirements and are recorded in accordance with federal accounting standards, (2) assets are properly safeguarded to deter fraud, waste, and abuse, and (3) performance measurement information is adequately supported (par.17).

## **3-2. Specific "Social necessity"**

By the above overview, the objectives of government accounting have been shown. So then, to achieve the objectives indicated by above-mentioned provision, we need to reveal the "Societal necessity" in the "Means". And the essence of "Means" (namely the line item in the financial statements) becomes apparent when having specified the "Social necessity". Therefore, it is possible to raise the "Question" caused by the lack of appropriate display in the financial statements.

**3-2-1. “Social necessity” in Balance Sheet**

As previously mentioned, GASB insists that the current generation of citizens should not shift the burden of paying for current-year services to future-year taxpayers. GASB defined this concept as “Interperiod Equity”. Therefore, financial reporting should indicate whether current year revenues are sufficient to pay for the services and future taxpayers will not be required to owe burdens for services previously provided.

So in Balance Sheet, after deducting liabilities from assets, it’s difference indicates a cumulative total of tax revenue which past taxpayers had paid. And the carrying amount of the liabilities indicates future taxpayers must assume burdens. Therefore, the ratio of debt to total assets indicates Interperiod Equity. The overview of this situation is as follows.

Balance Sheet	
(Assets)	(Liabilities)
	Future taxpayers will be required to assume burdens
	(Net Position)
	Past tax payers had paid a tax

**3-2-2. “Social necessity” in Flow Statement**

As for a flow statement, difference value of cost and revenue indicates situation of Interperiod Equity at a fiscal year. If cost exceeds the revenue, future taxpayers should be required to assume burdens for services provided this year. Grasping this amount, it will be able

Flow Statement	
Cost	Revenue
	Future taxpayers will be required to assume burdens

to assess the situation like this. For such reason, there is “Social necessity” in flow statement. The overview of this situation is above.

### 3-2-3. Cost Information as “Social necessity”

As previously mentioned, there are four objectives configured by FASAB. And the objectives directly related to this consideration is “Operating performance”. FASAB indicate the examples of display to accomplish the objective of operating performance (FASAB [1993], par.127). It is as follows;

- Information on the costs of programs and activities
- Cost comparisons with estimates, with similar functions
- Relevant analyses of the composition and behavior of costs, such as full and incremental costs, fixed and variable costs, direct and indirect costs

In FASAB, the main objective of display is assessment of cost performance.<sup>3)</sup> That is, administrative cost information should be the principal “Social necessity”. Also in Japan, MIAC describes that if we can evaluate the cost performance in flow statement, it is possible to examine the efficiency of administrative activities. MIAC insists that evaluation of cost itself that took to the service is the main point in accounting.

### 3-2-4. Summary of Section

Thus, “Social necessity” is reflected in the “Means” of accounting to achieve the “Objectives”. Here, it is summarized in two important points. Balance sheet and flow statement are needed to assess Interperiod Equity and to assess the cost of the administrative activities. Namely, “Interperiod Equity” and “Assess the cost” are the “Social necessity”.

## 4. Raising the “Question” Caused by the Lack of “Social necessity”

As described above, there are two societal necessities to achieve the accounting objectives. In this consideration, the “Means” in teleological relationship is financial statement for reporting information. So if we raise the question caused by the lack of societal necessity, we need to raise it from the statements. Therefore in this section, raise the “Questions” by considering accounting display structure in financial statement.

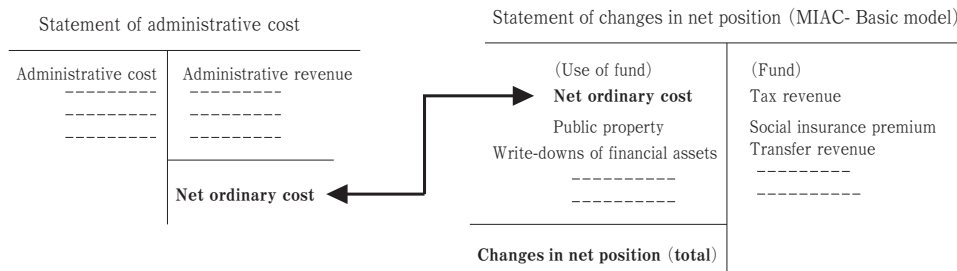


**4-1. Understanding Difficulty of “Interperiod Equity” in Flow Statement**

There is a complex linking structure between Statement of administrative cost and Statement of changes in net position in MIAC-Basic model. In this case, accounting users often can’t evaluate Interperiod Equity caused by the understanding difficulty of linking structures. So like this case, the “Question” caused by the lack of societal necessity may be clarified.

Generally in the statement of administrative cost, detail of revenue and administrative cost is displayed, and “net ordinary cost” is indicated in the bottom line. Moreover, this cost is displayed as the item at the statement of changes in net position (See Figure3). Namely, the bottom line in statement of administrative cost signifies value of fiscal measures, and it links with “Use of fund” section in the statement of changes in net position.<sup>4)</sup>

Figure 3 - Linking Structure of Two Flow Statements



In flow statement, as described above (Section 3), difference value of cost and revenue indicates the situation of Interperiod Equity. If the cost exceeds the revenue, future taxpayers will be required to assume burdens. So, cost and revenue should be displayed together in the statement of changes net position, and then it is possible to assess the situation of Interperiod Equity. Therefore, the function of the statement of administration cost could be replaced by statement of changes in net position.

From the above, difficulty of assessment due to the complex linking structure is set as the “Question”.

**4-2. Decline in Function of Cost Management Caused by its Classification Display**

As to flow statement of Tokyo model, cost items are displayed by classifying. Namely, there are allocated in three sections, “administrative budget”, “financial budget”, and “extraordinary balance of payments”. The overview of this statement is as follows.

Statement of Administrative Costs (Tokyo model)

Section of ordinary Balance of payments

I . Section of administrative budget

Administrative revenue

Administrative cost

II . Section of financial budget

Financial revenue

Financial cost

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Ordinary Balance of payments

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Section of extraordinary Balance of payments

Extraordinary revenue

Extraordinary cost

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Balance of payments at the end of fiscal year

As above, cost items are divided into several categories in statement of administrative costs. In upper division, it is displayed by “Ordinary Balance of Payments”, and divided into administrative budget and financial budget. And in each section, revenue and expenses are displayed as a pair. In lower division, it is displayed by “Extraordinary Balance of Payments”. Then finally, balance of payments is displayed at bottom line.

However in this model, it cannot display the cost collectively. So reduction of cost management function may occur. For citizens, assess of the administrative cost is the main objective and displaying the cost collectively is an appropriate for “Social necessity”.

## **5. Set of the Hypothesis for the Question**

As described in the previous section, there are two main question that caused by the lack of “Social necessity”. One is difficulty understanding of Interperiod Equity in flow statement caused by complicated linkage structure, and the other is decline in cost management function caused by its classification display. In this section, setting hypothesis for these questions with theoretical considering. Thereafter, it can be derived the conclusion to the question.

### **5-1. Set the Hypothesis for the Question of Difficulty Evaluating Interperiod Equity**

The first “Question” of the financial statement display is that there is complicated linking structure among flow statements. As explained above, the bottom-line of statement signify

values that indicate fiscal measures, and having linkage structure with “fund section” in the statement of changes in net position. Namely this cost implies a part of change in net position. In such situation, accounting users can’t easily evaluate Interperiod Equity in flow statement.

In such structure, we need to comprehend the accounting theoretical implications of each bottom-line and calculated structure. In other words, we must understand how evaluates Interperiod Equity. Therefore, if it is possible to evaluate Interperiod Equity only one flow statement, it may be more effective information for users. From the above, it can be set a target hypothesis, such as the following;

(Hypothesis- ①)

Display difference of revenue and cost at bottom-line in single flow statement,  
then evaluate Interperiod Equity easier.

#### **5-2. Set of the Hypothesis for the Question of Decline in Cost Management Function**

Because it does not display the cost collectively, there is a possibility of declining the cost management functions. As to some type of flow statement (Tokyo model for example), cost items are displayed by classifying in each section in correspondence with revenue.

On the other, displaying costs collectively (IPSASB model and MIAC-Basic model for example), cost management by information user may be facilitate. The main objectives of accounting for citizen who is a accounting user is to assess the administrative cost (see section3), so display the cost collectively in flow statement meets the social necessity. For the above reasons, it can be set a target hypothesis, such as the following;

(Hypothesis-②)

It is possible to manage the cost performance by displaying collectively in flow statement.

### **6. Verify the Hypothesis by Deductive Consideration**

Based on the target hypothesis indicated above, display criteria is considered and set to

establish the validity of assessing Interperiod Equity by displaying the balance difference, and the validity of executing cost management by display the cost collectively in one flow statement. So if the validity of two hypotheses is approved, specific display format will be defined. As described above (see section2), to reach a final conclusion, use normative-deductive consideration theory would be appropriate. That is, set the hypothesis including a “Ought” for the sake of solving the question at first, then verify the hypothesis in order to draw conclusion by deductive consideration based on prevailing theory and criteria.

In this section, the hypothesis would be tested by deductive consideration and derived the conclusions. At the process of consideration, appropriate display format is specified by referring to the concepts and standards of corporate accounting.

#### **6-1. Verify the Hypothesis ① (Set a Difference of Balance in the Bottom Line)**

In the previous section (Section4), manifested question is as follows;

(Question)

- It should be difficult to understand the accounting theoretical implications of each bottom line and the linking structure in two flow statements.
- In such display, evaluating Interperiod Equity may be limited.

And displaying element of cost and difference in the balance of payments, it is possible to achieve assessment of Interperiod Equity and cost control for information users by one flow statement. Therefore, hypothesis is set as follows;

(Hypothesis)

- Indicate a difference of revenue and cost in bottom-line of single flow statement, and evaluate Interperiod Equity easier.

In FASAB and MIAC-Basic model, a complicated linking structure among flow statements exists. And in such structure and display format, information users may feel difficult to evaluate Interperiod Equity. Therefore, at the bottom line, difference of revenue and cost should be set. Thereafter, we can evaluate Interperiod Equity easier.

As for MIAC-Basic model, there are two flow statements, namely statement of changes in net position and statement of administrative costs. The former indicates the resulting effect on the entity’s net position. The feature of this is that the capital variation of fixed assets and long-

term financial assets are displayed. So the bottom-line of this financial statement including capital flow is able to evaluate Interperiod Equity for the administrative activities.<sup>5)</sup>

On the other hand, in the FASAB model, for not including capital account, a current account is displayed. In this case, bottom-line displayed in this format is a current account balance.

As for these displays, there are three problems. The first point, linking structure is complexity and information users feel hard to understand it. The second point, cost information is not displayed appropriately. The third point, there is a problem of whether displaying the capital flow.

In contrast, as to IPSASB model (Statement of financial performance) and Tokyo model (Statement of administrative costs), taxes is included in the revenue section. In this case, the bottom line indicates a value of “difference of income and expense”, namely net changes in the total. And using this calculated value, an assessment of Interperiod Equity in current year and a management of the cost performance is possible.

Exactly speaking, in case not including capital flow, it is not able to evaluate Interperiod Equity. If government introduces a fixed asset that is financed by municipal bonds, deterioration of Interperiod Equity occurs. But this situation does not come out in flow statement and information users can't accept it.

However, elements of changes in net assets will be induced into Balance Sheet at settlement of account, and it is possible to evaluate Interperiod Equity. Described in Section3, a value after deducting liabilities from assets indicate total amount of tax which past taxpayers had paid. And the carrying amount of the liabilities indicates a value which future taxpayers will be required to pay. Therefore, the ratio of debt to total assets enable the assessment of Interperiod Equity in Balance Sheet.<sup>6)</sup> Moreover, it is possible to compare the amount of change in net position among several years.

From the above, by indicating a difference of revenue and cost in bottom-line, information users can easily evaluate Interperiod Equity and cost performance.

## 6-2. Verify the Hypothesis ② (Collectively Display for its Management)

In the previous section (Section4), manifested question is as follows;

(Question)

- In the specific form of flow statement (Tokyo model for example), cost item is displayed

by classifying.

- ・ Because it does not display the cost collectively, there is a concern of reducing the cost management functions.

As considered above, if display the cost collectively, appropriate cost management might facilitate. Because the main objectives of accounting is assessing the administrative cost by information users, so display the cost collectively in flow statement meets social necessity. For that reason, hypothesis such as the following have been shown;

(Hypothesis)

- ・ By displaying collectively in flow statement, it is possible to manage the cost performance.

As described preceding paragraph, the conclusion is that one flow statement could evaluate Interperiod Equity more easy. So this section will verify the validity of displaying the cost collectively in one flow statement.

Generally, government has to avoid financial difficulty and to “live within their means”<sup>7)</sup>. Therefore, financial reporting has to provide information that helps the user to assess the costs of providing activities. That is, matching display with the costs and revenues in the statement are not requested. Rather, displaying cost collectively in financial statement is proper to manage the cost performance.

As described in Section3, if the cost exceeds the revenue, future taxpayers will be required to assume burdens for services provided in this year. So information users can evaluate Interperiod Equity and cost performance simultaneously by financial statement.

As indicated in Section 4.2, cost items are displayed by classifying in Tokyo model flow statement. Namely, ordinary balance of payments section and extraordinary balance of payments section is displayed. And in each section, revenue and cost are displayed correspondingly. In such a format, it does not display the cost collectively and there is a concern of reducing the cost management functions.

If revenue and cost are separately displayed and cost is displaying collectively, it can be adapted to manage the cost performance. So the form of such financial statement is able to accomplish the objectives of governmental accounting. If difference of balance at bottom-line is positive, future taxpayers will not be required to assume burdens. So this function also

accomplishes the objectives of evaluating Interperiod Equity.

We can see such a display format in IPSASB model and MIAC-Basic model. In overview basis, the main difference is whether including the tax revenue or not. As for IPSAS model, including the tax revenue and it can be adapted to assess the cost performance. In the MIAC model, there is not included tax revenue and the bottom-line of financial statement signifies value of fiscal measures. The overview of IPSASB model is as follows.

<u>Statement of Financial Performance - IPSASB Model</u>	
Revenue	XXX, XXX, XXX
Expenses	XXX, XXX, XXX
Share of surplus of associates	XXX, XXX, XXX
Surplus/(Deficit) for the period	XXX, XXX, XXX

Source: IPSASB, 2006

The introduction in this paper, it was pointed out that we should aim standardization with corporate accounting to establish new government accounting system. However in corporate accounting flow statement, cost items are displayed by classifying. So standardization has not been achieved in this regard. Therefore, to assess the administrative cost, it is reasonable to display cost collectively. The format like that is easy to understand the result of cost. Through this display, cost management reduction can be avoided.

### **7. Conclusion**

This study has considered about standardization of the accounting display which based on prevailing view. As a study procedure, used teleological relationship theory and derived two hypotheses. And for hypothesis verifying, normative-deductive consideration was made.

In conclusion of the first hypothesis, we can easily evaluate Interperiod Equity by one flow statement that shows the difference of revenue and cost in the bottom-line. In the second one, displaying the cost collectively is better than classifying to assess the administrative cost.

From above, the standard format of the financial reporting can be shown as follows.

Statement of Government Financial Flow

Inflow Section

Operating inflow

Revenue XXX, XXX

Non-Revenue XXX, XXX

Capital inflow XXX, XXX

Outflow Section

Operating outflow

Administrative Cost XXX, XXX

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Capital Expenditure XXX, XXX

Changes in Net Position XXX, XXX

- 1) “Objectives” are set on the basis of social necessity, so teleological relationship theory provides a “point of view of the need” in the institutional design (Fujii [2010], p. 24).
- 2) An “Normative-deductive” consideration can draw a road map to achieve the exogenous objectives (Tokuga [2011], p. 2).
- 3) However in FASAB, the amount of supply cost in program activities (not whole government) is indicated.
- 4) Statement of changes in net position that presents the manner in which the entity’s net costs were financed and the resulting effect on the entity’s net position (FASAB [1995], par.60).
- 5) R. N. Anthony described that financial resources is composed of operating inflows and capital inflows. Operating inflows associated with operational activities for the year and is composed of revenue and non-revenue (Anthony [1978], p. 60).
- 6) Generally it is called the “Ratio of Equity and liability”.
- 7) GASB described that the laws of most governments require is balanced budgets (GASB [1987], par59).

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