# Reporting Vermont's Fiscal Condition: GAAP Accounting

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## Cash vs. GAAP Accounting

The state of Vermont currently maintains its accounting records and presents its financial reports using a cash basis of accounting. Under this system only transactions that result in an increase or decrease *in cash* are accounted for and reported. Other assets (amounts owed to the state) and obligations (amounts owed by the state) that do not affect the current cash position are not accounted for internally or reported externally.

Many in the financial community, including the agencies that provide credit ratings for the state's bonds, are concerned that they may not be getting a complete and accurate interpretation of the state's fiscal condition. Their concerns give to the question: "Should the state continue to account for and report its activities on a h basis or change its accounting and reporting practices to be consistent with generally accepted accounting principles (GAAP)?"

Supporters of GAAP accounting believe that it gives the state's legislative and oversight bodies, and investors, creditors, and citizens a more complete, more accurate, and more object account of the state's financial situation.

## Why Change to GAAP Accounting?

Vermont and West Virginia are the only two states that still prepare their fiscal activities on a cash basis. Converting to GAAP financial accounting and reporting offers the state significant advantages:

· Improves and expands information available for financial accounting, reporting, planning, and budgeting, which can strengthen decision-making in management and public policy areas.

· Enhances fiscal accountability which will improve the state's financial reputation and credibility with external organizations, rating agencies, taxpayers, and special interest groups.

· May reduce the interest Vermont pays on borrowed funds. (As rating agencies provide better evaluation of Vermont's fiscal condition based on more complete GAAP reports), interest rates may decrease.)

· Presents the state's operating results on a basis that is comparable to other states and forecasts anticipated financial commitments.

· Improves staff capabilities through training and professional development.

## A Look at the Issues

It is important to understand what converting to GAAP can and cannot do for the state. A number of issues need to be considered in making the decision to convert to GAAP.

### Political Issues

Changing to GAAP may make the financial position of the state *appear* worse than it does under the current cash accounting system. This change in financial position would not be a *real* decline, but would reflect a more complete accounting of assets and obligations than is reported using a cash-based system. Certainly, questions dealing with these "new" assets and liabilities could become politically sensitive.

A perceived decline in the state's financial position following conversion to GAAP would not actually indicate a poorer financial position or poorer financial management. GAAP accounting and reporting simply measure and report the effects of transactions on a more complete and objective basis than does cash accounting.

### Operational Issues

A conversion to GAAP may require changes in the accounting procedures currently used by the state. GAAP accounting and reporting require that more and different types of information be obtained by accountants and financial statement preparers. Accordingly, the state's current computerized and manual information systems would need to be reviewed to determine the extent to which they must be modified or replaced to produce needed information.

Along with a re-examination of the state's information systems, a re-evaluation of current state staffing would be required to determine whether the staff have the expertise and the time necessary to convert to GAAP in an effective and efficient manner. In conjunction with the review of starting needs, a time frame and budget for completing the conversion would be established. The cost estimate would include internal costs (e.g., payroll, training, systems changes, etc.) as well as the cost of hiring external consultants to aid with the conversion.

### Budgetary Issues

In addition to using a cash basis for accounting and reporting its financial activities, the state of Vermont, by statute, uses a cash-based budgeting process. Converting to GAAP accounting and reporting *does not* mean that the state's budgetary procedures - or statutes - need to change. Many state and local governments currently use GAAP for accounting and reporting purposes, and cash or other accounting methods for budgetary purposes.

### Financial Issues

The full impact of converting to GAAP accounting cannot be precisely estimated. It is generally believed that the conversion would initially result in the general fund surplus being lower or the deficit being higher than is currently reported on a cash basis. These perceived changes would be the result of the identification of assets and obligations that are not currently reported under the state's cash basis of accounting.

The extent of the impact can be controlled somewhat because of the flexibility that GAAP provides for recording these “additional" assets and liabilities. GAAP establishes rules that govern when these assets and liabilities should be recorded, but in determining the dollar amount of the assets and liabilities, GAAP provides the state with several alternatives. An examination of these alternatives needs to be performed to assess the potential impact on the general fund surplus of converting to GAAP.

## A More Effective Change

GAAP accounting is not a substitute for good management. It will not necessarily improve financial management, but it *can* ensure greater financial accountability. The Vermont Business Roundtable believes GAAP accounting provides more complete information to be considered when making decisions. It presents the fiscal health of the state in a more objective fashion to the state's citizens, its legislature, rating agencies, creditors, and investors. It offers a more effective basis upon which to monitor and handle the state's current - and future - financial condition.