7-26-2016

The Timeliness of State and Local Governments by GASB: An Evaluation of Efficacy of Financial Reports

Achraf Seyam
CUNY Borough of Manhattan Community College

Alexander Hinners
Hofstra University

Lauren Freire
Hofstra University

Victor Parbat
Hofstra University

Journal of Accounting & Marketing

Seyam et al. J Account Mark 2016, 5:3
DOI: 10.4172/2168-9601.1000184

Research Article Open Access

The Timeliness of State and Local Governments by GASB: An Evaluation of Efficacy of Financial Reports

Achraf Seyam[1]*, Alexander Hinners[2], Lauren Freire[2] and Victor Parbat[2]

[1]*Borough of Manhattan Community College, City University of New York, USA*
[2]*Hofstra University, USA*

Abstract

In March 2011, the Governmental Accounting Standards Board (GASB) issued a research brief titled "The Timeliness of Financial Reporting by State and Local Governments Compared with the Needs of Users." This study formally exposed an apparent gap between the time-of-issuance of governmental financial reports and their usefulness according to a large and diverse group of survey participants. According to the GASB in the aforementioned report, nearly a quarter of the government entities take longer than six months to issue their annual reports, with many evidencing release times of a year or more. Comparatively, the users surveyed indicated that report usefulness begins to decline substantially when the time to issuance exceeds 45-60 days. After six months the information is no longer considered timely and is significantly less useful to users of the financial statements, which include creditors and investors, such as banks and bondholders, respectively. Timeliness is one of the six qualitative characteristics that governmental financial reporting is expected to possess, and it is currently not being met. First, one of the key reasons timeliness is impaired is directly correlated with the relative complexity of GASB Standards; consequently, there is a need for a qualified management staff whom is specifically trained to interpret and implement GASB standards. Second, a lack of adequate internal controls leads to lack of communication and an overall inefficient reporting process. The governments, regardless of their size, should post relevant information within a timely manner, which is commonly benchmarked at six months. Thirdly, complex data gathered from consultants is difficult for staff to interpret. Finally, turnover of management is an inherent problem associated with this study. We believe this timing issue may be reduced by introducing better internal controls, information technology, and training of relevant staff, increased communication, and improved overall commitment by the government to issue these reports in a timely manner.

Keywords: Timeliness; State and local governments; Governmental accounting standards board; Complexity; Internal controls; Communication; Commitment; Information technology; Staff training; Competency; Audit skills

Introduction

Financial reports are intended to provide a transparent view of an organization. These documents allow organizations to be valued based on their performance and to be analyzed by third party users, such as investors, creditors and taxpayers. An efficient economic system with a defined securities market depends upon the reliability and usability of these statements. Without them, good decision-making would be nearly impossible. Financial statement verifiability is a cornerstone of efficient markets and is usually completed by an independent licensed CPA firm. One type of financial report that is used in the United States is the governmental financial report. Similar to all financial reports, they require an audit and should contain reliable and useful information for the users, the taxpayers and creditors such as banks and bondholders, to make informed decisions. Thus, timeliness of these statements is integral for proper investment and survival of governments throughout the nation. However, a major caveat rears itself when cost is considered. There is a direct correlation between rapidly prepared financial statements and accounting fees. According to PricewaterhouseCoopers (PwC), "as cost pressures mount and [entities] strive to report faster and more efficiently with fewer resources, finance leaders find that they can realize only so much speed before accuracy and control are compromised." [1]. As a result, a mixture of these variables must carefully be crafted to sustain the government and increase fidelity from citizens.

Problems

Lack of timely reporting

As explained above, governmental financial reports are extremely important to municipal bond analysts, legislative fiscal staff, and researches at taxpayer associations and citizen groups. According to the Governmental Accounting Standards Board, or GASB, governmental financial reports are considered useful up to 6 months after fiscal year end, but when they are received within 45 days this information is classified as very useful. Timeliness is determined by counting the number of days that have elapsed between the fiscal year-end and the date the financial report becomes available to the public. This document, "The Timeliness of Financial Reporting by State and Local Governments Compared with the Needs of Users," encompasses two major aspects, the analysis of the time lag between the fiscal year-end and the issuance of financial statements, and the effect of this lag on the usefulness of financial report information for decision-making.

The standards board considers timeliness while establishing standards for accounting and financial reporting; however, it does

***Corresponding author:** Achraf Seyam, Assistant Professor, Borough of Manhattan Community College, City University of New York, USA, Tel: 212 220-8354; E-mail: aseyam@bmcc.cuny.edu

Received June 11, 2016; **Accepted** July 19, 2016; **Published** July 26, 2016

Citation: Seyam A, Hinners A, Freire L, Parbat V (2016) The Timeliness of State and Local Governments by GASB: An Evaluation of Efficacy of Financial Reports. J Account Mark 5: 184. doi:10.4172/2168-9601.1000184

not require the financial reports to be done by a specific date. Timely information should be available when a company has to make a decision that directly affects a business. An issue inherent of current published government financial reports is found between the time that the end of the fiscal year is reported and the date the financial report is available to the public. Information is considered timely when it's available to users early enough to allow them to apply it in their decision making process. Therefore, GASB considers timeliness as one of the most important characteristics that financial report information is expected to possess in order to transmit information effectively, with relevance, understandability, reliability, and comparability. Therefore, it is crucial for users of governmental financial information to receive the information as soon as possible in order to make the necessary decisions.

The GASB conducted extensive research and evaluated the financial reports of the contiguous 50 states, 100 largest counties and localities, as well as, the 50 largest independent school districts and special districts. As stated by the GASB research, it was found that "the largest local and county governments and independent school districts issued their financial report approximately 6 months after fiscal year-end on average during fiscal years 2006-2008. State governments averaged closer to seven months, whereas special districts averaged about four months." They also found that overall, less than 46 percent of the smaller governments provided their reports within six months; in addition to that seven percent took even longer than one year (Figure 1).

In 2005, the GASB surveyed about 250 users of governmental information and found that one major issue they wanted to bring to the attention of GASB, was that the reporting needs to be more timely. Although timeliness is a very important qualitative characteristic, the GASB does not and cannot require the financial reports to be issued by a certain date. Not much research exist on the topic of timeliness until recently, however the goal they're trying to achieve is to figure out how long it takes to issue audited financial reports and how time affects the usefulness of financial reports.

With the research conducted, 89 percent of the respondents of a survey done which compared the usefulness of financial statements in accordance with their time-to-issuance rated information that was received within 45 days to be considered useful, for 3 months it dropped to 44 percent and for 6 months it plummeted to less than 9 percent. The information presented conveys that the usefulness of the information decreases in value due to the timing of reporting in "23 percent of the larger government financial reports and 44 percent of the smaller government financial reports". The 45-day threshold for usefulness is also found within the corporate sector, according to the Public Company Accounting Oversight Board release No. 2015-008, which suggests that timely information is essential for any industry to receive the intended benefits of investor knowledge [2] (Figure 2).

Audit timing developed in the corporate sector does not match with the government sector. The government sector has developed three groups of influencing factors: competency of the government's financial management, competency of the auditor, characteristics and complexity of the government. The users of governmental financial information view timeliness as an important and useful quality. Evidence demonstrates that 70 percent of audited financial statements are considered useful when received in 9 months and 89 percent statements received after 10 months are no longer consider useful. It is reasonable to not find information received after such time useful because they could potentially be basing their decision on outdated information.

Therefore, it can be established that it is essential to report financial information in a timely manner. Even though the usefulness of financial statements diminishes less for larger governments as compared to smaller governments. The longer governments wait to release their annual reports and the accompanying financial statements, the information becomes less stable and less useful. Thus, an inverse relationship exists among the passage of time between the fiscal year-end and the issuance of financial report against the usefulness of these financial statements for decision making.

Governmental overlap

The United States Government Accountability Office (GAO) [3], which is a nonpartisan organization that examines how the federal government spends its resources, defines governmental overlap as "an issue that occurs when multiple agencies or programs have similar goals, engage in similar activities or strategies to achieve them, or target similar beneficiaries" (GAO 2). Governmental overlap is a severe problem that exists in most systems of formalized authority; including state and local governments. The core of this issue stems from its inherent inefficiency; which ultimately affects the quality and timeliness of most affected tasks. The failure of proper inter-departmental coordination creates a snowball effect of wasted resources, which could be used to improve the timeliness of the given project. For example, the Comprehensive Annual Financial Report (CAFR) is a massive document prepared by most state and local governments to help display the financial health of the entity and helps users make educated decisions. The complexity of this report often requires multiple segments within the government to coordinate

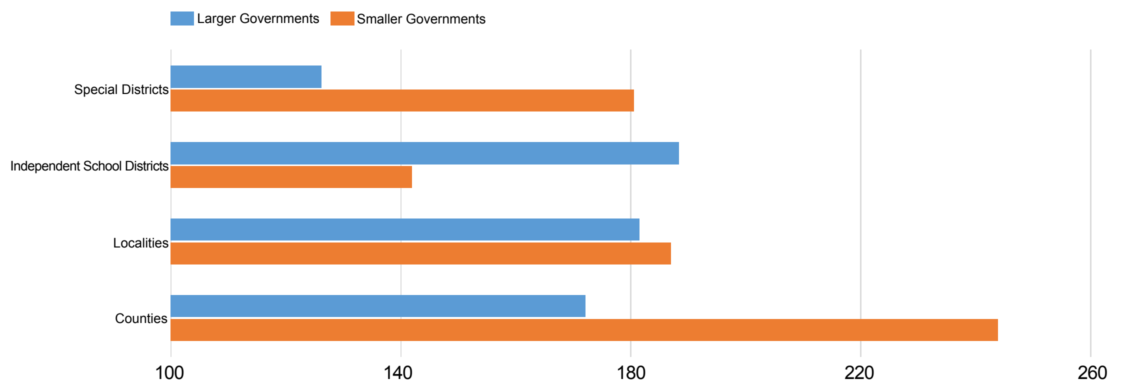

Figure 1: Average days to issuance.

Citation: Seyam A, Hinners A, Freire L, Parbat V (2016) The Timeliness of State and Local Governments by GASB: An Evaluation of Efficacy of Financial Reports. J Account Mark 5: 184. doi:10.4172/2168-9601.1000184

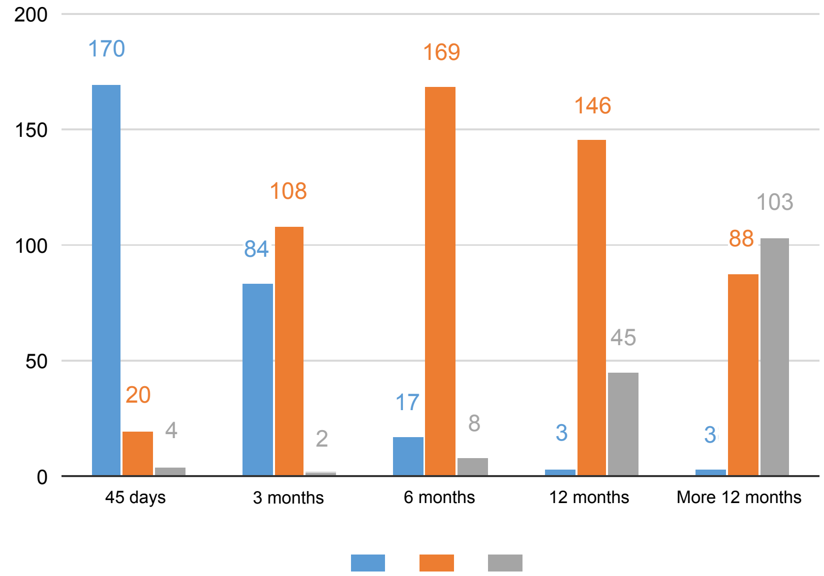

Figure 2: Usefulness of financial statements versus time to issuance.

their projects. However, miscommunication can lead to multiple groups working toward the same goal, and ultimately governmental overlap. As a result, this leads to an enormous waste of resources; for example, a government may appropriate four members of its staff to work on a job which requires only one employee. This means the government is wasting the labor of three employees who could be working on another segment of the financial report; which would lead to a quicker time-to-issuance. The government is also squandering resources on overlap because the extra employees are producing redundant information. The government could use this money to perhaps hire more employees or purchase better equipment to improve the time-to-issuance of the annual financial report. As a result, governmental overlap inefficiency is a key factor in the unreasonable reporting times of state and local governments.

Causes

Complexity of standards

Generally Accepted Accounting Principles (GAAP) was created to make financial statements easier for accountants and potential investors to understand. Ironically, as time moved on accounting has become so complicated that even some accountants struggle to understand all the items that are on a financial statement. This raises the question "what makes accounting so complicated?" The answer as described in the article "Will Simpler Also be Better?" by Maria L. Murphy, CPA, [4] claims that what makes accounting so difficult is the massive information overload. For investors, it is important to know what information you need in order to make a smart investment; however, when faced with hundreds pages of information it becomes hard to decipher what kind of information is necessary.

As suggested in the article a "Simplified Accounting Standards Can Help Lessen the Burden on Finance Staffs that are Busy with Reporting, Strategic, and Compliance Responsibilities," simplifying the GASB financial reporting style will not only promote less stress for the accountant, but it would also provide investors with more necessary information that is not hidden or overshadowed by irrelevant data. Thus, if there was less cumbersome information, the financial statements would be easier to understand. However, in order for this to transpire, accountants would have to analyze and separate information that is relevant and irrelevant on financial reports. Although, relevance is partially subjective and partially objective; what may be considered essential for one investor might not be crucial for another.

In addition, in order to keep up with standards if they are changed, current employees would have to be re-educated and "the time and money required to make the changes, including implementation efforts and educating staff, management, and boards, may not be perceived to be worth the benefit". Financial statement preparation is a difficult process that takes time; which is not favorable and costly for the company preparing it, and the investors who rely on these reports.

Second, the complex nature of the government standards is the root cause for the need for an audit company with vast resources and technical expertise. As a result, the Big 4 Audit firms - PwC, KPMG, Deloitte, and Ernst and Young - are often contracted to help midsize-to-large governments prepare their annual reports. Utilization of these firms is coupled with a large fee, which is levied by those who give the largest revenue to the government: the taxpayers. However its important note to point out that once this relationship is established, governments seldom change their auditors. According to the Office of the New York City Comptroller's Comprehensive Annual Financial Reports from 2002 to 2015, the independent auditor that has been hired was Deloitte (formerly Deloitte and Touche). This lack of change occurs because of the complacency found when an audit-client relationship is well-established. Yet, the "people of the city of New York" are the ones who must question how well these audits are done. In their article, "The Effect of Auditor Changes on Audit Fees, Audit Hours, and Audit Quality," authors Donald Deis, Jr. and Gary Giroux conclude [5]: "first year independent audits had statistically lower audit fees. Despite the lower fees, quality was higher and more audit hours were utilized." [5] Thus, as more than 13 years has elapsed, the auditor has become complacent and less quality may be given.

Turnover of key staff, lack of educational levels

High turnover levels of key staff within the government have been a contributing factor to the delay of governmental financial reports. As previously mentioned, governmental reports deal with complex standards that require a level knowledge and familiarity in order to be implemented and applied correctly and efficiently. When staff members continuously leave each year, often times before year-end, there is a lapse of knowledge and familiarity with these complex standards. Without those two aspects, additional time is required to make sure reports are being done correctly and standards are being applied accurately. Governmental bodies also have to go through constant recruiting, hiring, and training of new personnel in order to fill these roles. This adds on additional time before the financial reports can be completed. High turnover rates are an inherent aspect of the governmental sector but there are things that can be done to help ease the transition between the predecessor and successor; such as permanent hiring of knowledgeable and competent staff.

A consistent demand for key staff can often times lead to hiring staff members who would otherwise lack the educational levels needed to fully comprehend the standards. The pressure of time to fill these roles can cause the employment of under qualified staff. Additional time is required to further train the new personnel because of the lack of education and experience in the applicable industry. If the governmental body lacks a strong training program, a staff member could end up applying the standards incorrectly, have computation errors, or be in constant need of help to complete the reports; which would further add time to complete and issue the reports. Also, without adequate and qualified staff members the reports are more susceptible to human error.

Communication with consultant

Whenever there is an area in an audit where special professional judgment is required above the realm of expertise of the audit team, a consultant may be contracted. These consultants are often used to help determine key pervasive line items such as the accounting value of natural resources (coal mines or oil reserves) or intangibles such as patents or trademarks. The need for these consultants differs for each engagement. Communication with these individuals is crucial in determining balances that are not only reliable but also verifiable. However, timeliness may be lacking. As these consultants are contracted to provide crucial information for an audit, they bear the burden of having to provide information that will not only be scrutinized by investors in the public sector, but also the state and local governments themselves. Thus, their work should not be rushed, and as a direct consequence takes a long time to assemble further compounding in the delay of the release of the annual report.

Lack of internal controls to assist with reporting

Internal controls aim to promote effective and efficient operations in every aspect of governance; however, achieving this goal is a long and difficult process which requires ample attention. Correspondingly, a lack of sufficient internal controls, within state and local governments, has been an important factor in the gap between the timeliness of annual financial reporting and their usability among users. The core of this issue stems from a failure of many governmental entities to implement proper controls regarding the clear and accurate communication of reporting financial information. Without a sufficient system that requires informing others of complications or delays, state and local governments of all sizes will not be able to allocate the suitable resources to combat the problem. As a result, one area of the government will face immediate interruption, while the rest will encounter delays in the future as it encounters the impact of the prior setback. Also, without a control that allows quick contact with management, government staff may experience deferment when tackling difficult circumstances. For example, if an employee is unable to coordinate with their manager, he or she may make errors that could otherwise be prevented through readily available contact; which would ultimately lead to a stoppage in the future. As a direct consequence, difficulty to communicate, because of a lack of sufficient control, creates problems both with source internal and external to the government itself.

Component units are defined in GASB No, 14, The Financial Reporting Entity, as "a legally separate government for which the elected officials of a primary government are financially accountable, can impose their will, or there is the potential for the organization to provide special financial benefits to, or impose specific financial burdens on, the primary government." (GASB, The Financial Reporting Entity) [6]. Being "financially accountable" for these organizations requires state and local governments to obtain the necessary information needed to fairly represent the entity in their annual financial report. However, governments may find it difficult to coordinate differences in their reporting process and audit agenda. (GFOA Powerpoint 10) Without sufficient controls, contact with the component unit(s) often results in a prolonged process to transferring the correct information due to the disparity of their year-end timeline. A delay in a major segment of the annual financial report can lead to a crucial setback in the overall reporting process. Differences in the issuance schedule also presents a significant issue with overlapping governments.

It is important to remember that overlapping governments is different from governmental overlap. Governmental overlap is essentially lack of proper communication between entities from within the government. Overlapping governments is the multi-layered system of authority found within a republic. Municipalities must report to the states and the states report to the federal government. Once again, without adequate controls, many of the problems found with component units exist within this multi-layered governmental structure found within the United States. However, due to the size and scope of this matter, the procurement process is often even more prolonged and difficult to manage, which eventually creates more delays and issues.

Solutions

Implementing information technology solutions

One solution to assist in timely reporting for state and local government financials is the use of information technology. With the increasing need for technology to assist in controlling and storing vast amounts of data, it would be wise to employ universal accounting information systems across state and local government agencies to help with the following crucial elements of preparing financial statements:

- Consolidation across governmental components
- Automatic updating for intra-governmental transactions
- Graphical representation of data
- Verifiable audit trails

As far back as 1974, accounting research concluded that effective management and improved decision making derives from efficient accounting information systems. Information systems were once feared to replace managers, but have since been deemed crucial for improved decision-making [4,7]. Standards should be issued by the GASB to recommend the use of information technology as the start-up costs are insignificant to the potential benefits. If need be, companies could even develop their own databases using Microsoft Access or spreadsheet software's such as Microsoft Excel. Further, using software's that are pre-configured out-of-the-box helps in the recording and reporting processes because component departments will not have differing systems/platforms by which they report. As a result, roll-ups or consolidations will be much easier and less time extensive. Finally, with a clear methodological audit trail, those in the audit firms will have a clear indication of internal controls and overall reporting across agencies [8].

Better Communication/Internal Controls

Fostering better communication in all aspects of the reporting process will greatly increase the ability for a state or local government to issue their annual financial statements in a timely manner [9]. This idea can be facilitated by the implementation of improving internal controls. Procedures that promote reasonably consistent contact between internal offices of the state or local government will have numerous positive effects. Informing other departments of delays or other issues will allow teams to adjust their schedule to create the most fair and timely outcome possible. Also, improved communication between departments will help decrease governmental overlap because frequent contact may expose the redundancy of work being undergone. Being able to coordinate staff with top management on a prudent basis will likely reduce the volume of miscues, as well as, decrease the time to fix an error. Lastly, creating a relationship with component units through contact on a year round basis will likely ease the difficulty of receiving necessary reporting information. Year-round communication will help prepare both parties for transferring information when necessary to improve the overall timeliness of both reports [10].

Better training

A strong training program can offset much of the impact of a constantly changing staff. A training program should be designed to ensure the new employees have a knowledgeable background in government accounting and an adequate level of understanding of how to apply the standards and complete the reports. Upon employment, the hired staff should also have a level of education that would make them a satisfactory candidate for the job. This will be helpful in creating an encompassing training program where all applicants are instructed from a base level of knowledge in government accounting and reporting. The training program should be thorough and taught by an experienced staff member. It would be beneficial for the training program to include cross-training staff, which will help in reducing the impact of staff turnover. If staff members have knowledge about the procedures and reports done by one another, they can more easily transition or replace an existing employee. Current staff members should also provide thorough documentation of the procedures they are undergoing. This documentation will be extremely helpful in transitioning the new personnel and in training them.

Conclusion

For all of the above suggestions to be successful in reporting governmental reports in a timely manner, there must be a high level of commitment from the organizations. Governmental organizations should make timeliness a priority and goal. As seen in Figure 2, the usefulness of reports significantly decreases after 6 months of issuance. Governmental organizations should be providing its users with relevant information in order for it to be useful. If entities do not prioritize providing timely financial statements, then users will be forced to use outdated reports to make time-pressured decisions. The above suggestions aim to implement prioritizing timely reports that will help give users what is necessary for them to make these determinations. To reiterate, timeliness is one of the most important characteristics financial information should possess, and thus governmental organizations should be committed to maintaining this characteristic in their reports.

Timeliness of governmental reports can be achieved, as it has been done within specified time frames in New York and Michigan. It is required by state law for New York State and the City of New York to issue their audited financial reports within a time period of four months. The state of Michigan has issued its audited financial statements within three months. It is clear that reports can be completed and issued within a timely manner, but it requires an intense commitment from the organization. To encourage timely financial reporting, a Certificate of Achievement for Excellence in Financial Reporting, awarded by the Government Finance Officers Association, can be achieved by governmental organizations if their reports are issued within six months of their year-end date. However, as GASB explains in their research, this is outside the usefulness period. Perhaps with this information, the GFOA can institute a more "useful" issuance date. As stated previously, timeliness is one of the six main qualitative components of governmental financial reporting; as a result, state and local governments should attempt, with the prior suggestions in mind, to issue accurate financial statements within an acceptable time period. If this is done, reporting information will be much more useful, the user decision process will be made much easier, and a more financially harmonious environment will be created.

References

1. PricewaterhouseCoopers (PwC) Advisory Services (2010) Achieving more timely, accurate and transparent reporting: Smart, efficient close-to-report cycles create a foundation for evaluating performance, supporting business decisions and satisfying external reporting requirements.
2. Public Company Accounting Oversight Board (2015) Improving The Transparency Of Audits: Rules To Require Disclosure Of Certain Audit Participants On A New PCAOB Form And Related Amendments To Auditing Standards.
3. U.S. GAO (2015) Additional Opportunities to Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits.
4. Murphy ML (2015) Will Simpler Also Be Better. CPA Journal of Accountancy.
5. Deis D, Giroux G (1996) The effect of auditor changes on audit fees, audit hours, and audit quality. Journal of Accounting and Public Policy 15: 55-76.
6. Governmental Accounting Standards Board (GASB) (2011) The Timeliness of Financial Reporting By State and Local Governments Compared with the Needs of Users.
7. Atler SL (1976) How Effective Managers Use Information Systems. Harvard Business Review.
8. Cagle CS, Flesher DL, Pridgen AB (2014) Audit Report Timeliness of United States Local Governments: An Investigation of Entities Exceeding Reporting Deadlines. Accountancy Business and the Public Interest.
9. Munch J (2015) Excel' Eerating the CAFR, Practical Tips for Speeding up Production of the CAFR.
10. Turpen RA (2012) The Timing of Annual Financial Reports of Large U.S. Cities. Proceeding of the Academy of Accounting and Financial Studies.

Citation: Seyam A, Hinners A, Freire L, Parbat V (2016) The Timeliness of State and Local Governments by GASB: An Evaluation of Efficacy of Financial Reports. J Account Mark 5: 184. doi:10.4172/2168-9601.1000184