

September 4, 2001

Mr. Tom Allen, Chair
Governmental Accounting Standards Board
401 Merrit 7
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Dear Tom:

Thank you for taking time to attend the most recent annual conference of the Government Finance Officers Association (GFOA) this past June in Philadelphia. We are always pleased to have members of the Governmental Accounting Standards Board (GASB) join us at our annual conference.

We are especially glad that you had the opportunity to discuss the issue of GASB's role in performance measurement directly with our Executive Board. You undoubtedly noted the breadth and depth of feeling on this issue among our board members. You also are aware that GFOA has held this same position consistently for almost a decade. Nor is GFOA alone in its concerns regarding GASB's continuing involvement with performance measurement. All of the major governmental public interest groups took much the same position in a letter to the Financial Accounting Foundation (FAF) dated February 1, 2000 (See Attachment A).

We appreciate your willingness to discuss this important issue frankly and openly with our Executive Board in Philadelphia. Likewise we appreciate your effort to further elucidate your position in your letter of July 20, 2001. Unfortunately neither your remarks at the Executive Board meeting nor your subsequent written comments in any way alleviate our fundamental concerns regarding GASB's involvement with performance measurement.

Before proceeding any further, however, let us take a moment to eliminate any possible misconceptions regarding GFOA's fundamental support for performance measurement. GFOA is a strong and forceful advocate of performance measurement and has actively encouraged its application in practice. Indeed, GFOA's Executive Board just approved a comprehensive strategic initiative designed to promote the expanded use of performance measurement at the state and local level (See Attachment B). Recent GFOA actions to promote performance measurement include the following:

- Special recognition in GFOA's Distinguished Budget Presentation Awards Program of governments that are considered to be outstanding for their integration of performance measures into the budget document
- Nation-wide satellite training on performance measurement
- National training seminars on performance measurement
- A new publication on *Performance Measurement* in GFOA's highly popular *Elected Official's Guide* series.

Normally, GFOA seeks out opportunities to work with other groups that share common goals. For example, GFOA was a strong supporter of the National Advisory Council on State and Local Budgeting, which identified performance measurement as an essential component of a sound budgeting process. Likewise, GFOA has supported the research on performance measurement undertaken by the International City/County Management Association. We cannot, however, similarly support GASB's service efforts and accomplishments (SEA) project.

Objections to the character and direction of GASB's SEA project. One reason for our opposition to GASB's SEA effort stems from its fundamental character and direction, *as described by the board itself*.

1. ***GASB does not intend to limit itself to purely financial measures.*** GASB's commitment to performance measurement explicitly extends to *nonfinancial* measures of performance.

Because...information about SEA (in terms of outputs, outcomes, and efficiency) is an essential part of the measurement of performance, financial reporting needs to be expanded to include those measures. [GASB Concepts Statement No. 2, paragraph 49]

The board goes on to clarify the types of *nonfinancial* measures it believes need to be included as part of *financial* reporting:

Outcome measures... measure accomplishments or results that occur (at least partially) because of services provided. Results also include measures of public perceptions of outcomes. For example, measures may include the percentage of students achieving a specified skill-level gain in reading; the percentage of the population being served by public transportation; the percentage of lane-miles of road in excellent, good, or fair condition; and the clearance rate for serious crimes or the percentage of residents rating their neighborhood as safe or very safe. [GASB Concepts Statement No. 2, 50b(2)(a)]

For example, GASB's research report on SEA measures for elementary and secondary education mentions both of the following as potential *outcome* indicators:

- Percentage of students rating as good, excellent or improved their own work and study skills, self-discipline, interpersonal skills, and knowledge gained.
- Percentage of students scoring higher than specified level of self-esteem.

2. ***GASB's ultimate goal is to mandate, not recommend.*** Some individuals, including certain GASB board members, have argued that the board is only interested in conducting research and promoting experimentation and would never actually mandate standards. Unfortunately, this view is difficult to reconcile with the board's position as described in the "Basis for Conclusions" of GASB Concepts Statement No. 2.

Several respondents [to the exposure draft] suggested that SEA measurement and external reporting should be done only on a voluntary basis and that the GASB should not make SEA reporting part of GPEFR [General purpose external financial reporting] requirements. This suggestion was countered by others who noted that various forms of SEA reporting have been encouraged on a voluntary basis for several decades, and that even with efforts to encourage state and local governmental entities to develop and report these measures, there has been little movement toward comprehensive and consistent reporting of this information. The Board believes that unless SEA reporting is required, necessary information about the results of government services needed to assist financial report users in assessing the performance of governmental entities will be unavailable to most of those users." [GASB Concepts Statement No. 2, paragraph 93] (emphasis added)

Furthermore, GASB chose to highlight its unique ability to *mandate* standards in its successful application to the Sloan foundation for a major grant to fund SEA research.

We believe there is a need for (1) developing and improving measures of performance, (2) making those measures available to users by *requiring* performance measures to be included in the general purpose external financial reports of governments..." [Grant proposal to the Alfred P. Sloan Foundation, page 5] (emphasis added)

It is also likely that without a *requirement* for governments to report service efforts and accomplishments information, most governments will not include *nonfinancial* performance measures in their external reports." [Grant proposal to the Alfred P. Sloan Foundation, page 5] (emphasis in original)

We believe that to achieve broad use and reporting of performance measures in this country, *it will be necessary for our Board to require service efforts and accomplishments information to be*

included in general purpose external financial reports.” [Grant proposal to the Alfred P. Sloan Foundation, page 9] (emphasis added)

3. ***GASB is significantly expanding the boundaries of what constitutes “accounting and financial reporting.”*** State and local governments agreed in 1984 that GASB should set standards for *accounting and financial reporting*. GASB freely admits that SEA reporting goes *significantly* beyond the boundaries of accounting and financial reporting as those terms traditionally have been understood.

Including SEA measures as part of GPEFR represents a significant modification in financial reporting practices for state and local governmental entities. Historically, GPEFR has been concerned primarily with information that is financial in nature. However, SEA measures include not only financial measures, but also information about the inputs, outputs, and outcomes that may be measured in nonfinancial terms.” [GASB Concepts Statement No. 2, paragraph 69]

Thus GASB by its involvement in SEA reporting is unilaterally and arbitrarily extending its own jurisdiction.

4. ***GASB has already made up its mind.*** GASB argues that its research is designed only to determine the *feasibility* of setting SEA standards, and that no decision has yet been reached on whether the board will ever actually set such standards. Several factors, however, appear inconsistent with this assertion. First, the title of the series of research reports on SEA reporting published by GASB was *Service Efforts and Accomplishments Reporting: Its Time Has Come*. Second, the GASB has already accepted in principle that SEA information should be an integral part of financial reporting.

Having considered the information users need for assessing accountability and making decisions, and the role of financial reporting in providing information to assess performance, the GASB believes that SEA information is an integral part of GPEFR.” [GASB Concepts Statement No. 2, paragraph 49]

Are we to believe the GASB would elect *not* to include information that it already has publicly declared to be *integral* to financial reporting? Finally, the assertions made to the Sloan Foundation appear to reflect little real doubt regarding the probable eventual outcome of the board’s research.

5. ***GASB may seek the advice of experts before setting SEA standards, but it intends to have the final word all to itself.*** The board indicates that it intends to rely upon experts in the relevant disciplines when selecting performance measurements for inclusion as part of financial reporting. While this may be true, GASB still intends to have the final word:

The services provided by state and local governmental entities are diverse and often complex in nature. Specific technical knowledge often is needed to develop relevant SEA measures for a service. The GASB cannot by itself determine the specific SEA measures that should be reported. Therefore, in addition to accountants and others involved in financial management, it is essential that other management personnel (including program personnel, budget personnel, performance evaluators, and professional groups), internal auditors, and elected officials, citizens, and other users become active in developing and using SEA measures. *The SEA measures developed, reported, used, tested, and analyzed by these groups and others would form a set of SEA measures to be considered by the GASB in its process of establishing SEA reporting requirements.*” [GASB Concepts Statement No. 2, paragraph 73] (Emphasis added)

GASB already seeks the input of interested parties before setting accounting and financial reporting standards. Such due-process procedures, however, have not deterred the board from taking positions on a number of important issues that were at odds with significant portions of its own constituency (e.g., infrastructure reporting). Why would GASB hesitate to follow its own best judgment in the case of SEA measures? Furthermore, the experience of one of us, Tim Grewe, as a task force member for GASB gives us cause for concern. I received some information more than a year ago, upon my appointment to the SEA task force, but I have had only one subsequent communication from GASB

since that time, which was purely informational. We fear that the SEA task force may be little more than a sounding board for GASB staff documents, with no real opportunity for direct exchanges between task force members. Those with whom the GASB consults should not be deprived, in our view, of the benefit of hearing *directly* the concerns of professional public management organizations.

6. ***There will need to be some degree of auditor involvement, which will result in increased costs for state and local governments.*** While it is true that not all information mandated by GASB must be included within the scope of the financial statement audit (e.g., required supplementary information), it also is true that there will need to be *some* form of auditor involvement.

For SEA information to be of value to users, it is essential that it be reliable. To be reliable, the information should be verifiable and free from bias and should faithfully represent what it purports to represent. Therefore, SEA information should be derived from systems that produce controlled and verifiable data. The value of a strong internal control structure has long been recognized when dealing with financial information. If SEA information is to be considered for inclusion as part of the information required for GPEFR, *it is important that the systems and methods used to gather and verify the information be subjected to analysis similar to that used for financial information systems.*" [GASB Concepts Statement No. 2, paragraph 66] (emphasis added)

Such auditor involvement would inevitably result in additional costs, especially as many of the systems used to collect nonfinancial data have never been studied by auditors in the past as part of the financial statement audit.

Objections based upon incompatibility with effective performance measurement. An even more important reason that we object to GASB's SEA effort is that we believe it to be fundamentally incompatible with effective performance measurement.

To be effective, performance measurement must be thoroughly integrated into a government's budgetary process. This natural relationship between performance measurement and budgeting, which is reflected in all of GFOA's training and materials on budgeting, was underscored in the Budget Council's *Guidelines*, and can be briefly summarized as follows:

- A government uses *strategic planning* to identify its broad organizational objectives, which it then translates into specific *goals and objectives*.
- A government frames its budgetary decisions on the basis of *results and outcomes* that are directly linked to these specific goals and objectives.
- A government uses *performance measures* to monitor actual results and outcomes.
- A government compares actual and projected results and outcomes and uses this analysis as a basis for identifying any *adjustments* that are needed.

Consequently, to be effective, performance measures must be *specific* rather than *generic*. That is, a performance measure is only relevant to the extent it is clearly linked to the goals and objectives a government has set for itself. Furthermore, inasmuch as goals and objectives reflect public policy, it is only to be expected that they will differ, sometimes substantially, from government to government.

GASB's involvement with SEA is fundamentally incompatible with the understanding of performance measurement just described for a variety of reasons:

- GASB standards or recommendations would inevitably involve *generic* measures, which would break the crucial link between performance measurement and a government's *specific* goals and objectives.
- In the public sector, goals and objectives are the concrete realization and reflection of *public policy*. In a democracy, it is the unique prerogative of *elected officials* to set public policy. If GASB were to mandate the reporting of specific performance measures it would effectively be usurping this prerogative.

- There is no such thing as a “neutral” performance measure. The selection of what to measure will inevitably drive performance. Therefore, it is unrealistic to believe that performance measures mandated by GASB would remain “purely informational” and somehow *not* have an effect on how government’s manage their programs. Even were GASB to establish purely “voluntary” measures of performance for those governments that wish to use them, the very existence of benchmarks established by a national standard-setting body would place pressure on governments to conform their own performance measures to GASB’s model measures.
- As already noted, performance measures must be tailored to fit a government’s specific circumstances. Accounting standards, by their very nature, tend to take a “one size fits all” approach that would tend to focus on what is easy to measure rather than on what ought to be measured (e.g., the use of historical cost depreciation). Priorities and needs naturally vary among governments, and so too must performance measures if the latter are to be relevant.
- The inclusion of performance measures as part of financial reporting inevitably would require at least some degree of involvement on the part of the government’s independent auditor, resulting in additional audit costs. While we freely admit that data verification is essential if performance measurement is to be credible, we do not believe it should be necessary to involve independent auditors for this purpose. Internal auditing procedures should be sufficient.
- Performance measures are inherently budgetary and managerial in character and clearly outside the purview of accounting and financial reporting as those disciplines have traditionally and commonly been understood.
- Expertise in accounting, while invaluable in many aspects of public finance, does not provide a sufficient basis for making decisions regarding how to measure the quality of services. Even if subject-matter experts were consulted, as the GASB promises, the fact remains that the ultimate decision would still be GASB’s. Our own recent experience with infrastructure reporting should serve as a salutary reminder that GASB will not hesitate to issue standards at odds with the views of those it has consulted.

Conclusion. The real issue is GASB’s legitimate jurisdiction. *Governments* created GASB as an independent body to set standards of *accounting and financial reporting*. GASB’s legitimacy ultimately rests upon this delegation of authority by state and local governments. State and local governments have no trouble accepting GASB’s independence and authority in all issues related to accounting and financial reporting. GFOA, for instance, has continued to support GASB in its accounting standard-setting role despite serious disagreements that we have had with the board on a number of important technical issues. Governments’ willingness to accept GASB’s authority, however, is strictly limited to the sphere for which it was created, i.e., *accounting and financial reporting*.

Unfortunately, GASB has employed the irredeemably nebulous “concept” of *accountability* (a concept created by none other than GASB itself) to theoretically justify its potential jurisdiction over virtually *any* aspect of public finance. In the specific case of GASB’s SEA project, the board proposes to go well beyond *financial* data and actually highlight such *nonfinancial* and inherently subjective aspects of performance as quality of service measures (which, in our view, clearly are a matter for individual governments to decide for themselves). Thus, the organizations that now object to GASB’s involvement in performance measurement are the same ones that have supported GASB consistently since it was first established in 1984.

GASB seems to believe that it can be a party to the case at issue as well as the ultimate judge of its outcome. We refuse to accept this clear conflict of interest. GASB is effectively proposing to widen substantially the scope of its own jurisdiction unilaterally. State and local governments cannot accept such an arrogation of power, especially when it threatens the unique claim of elected officials in a democracy to set public policy. Consequently, we plan to urge FAF to use its oversight powers to reestablish the

appropriate boundaries of GASB's jurisdiction so that the board once again can devote all of its scarce resources to meeting the objectives for which it was created.

Any attempt by GASB to deal with matters that are clearly well beyond its expertise and competence can serve only to compromise the board's overall credibility and thus hamper its effectiveness in its proper role as a standard-setting body for accounting and financial reporting. Also, it is unthinkable that elected officials would stand by idly were GASB to attempt to indirectly override or supplant their public policy decisions. Furthermore, the controversy surrounding GASB's involvement with SEA reporting is more likely to hamper rather than to promote performance measurement.

We wish to appeal to you, as chair of GASB, to take a leadership role in steering the board away from the undoubtedly well intentioned, but ultimately misguided path it has taken with SEA reporting. We assure you that GFOA and other public-finance organizations are already doing the research and identifying the policies and practices that are needed to aggressively advance the cause of performance measurement in the public sector.

Once again, we wish to express our appreciation for your own efforts, and those of your colleagues on GASB, to respond to our concerns. If you have any questions regarding our position on performance measurement, please feel free to contact either of us directly.

Sincerely yours,

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Government Finance Officers Association

Jeffrey L. Esser, Executive Director
Government Finance Officers Association

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Donald J. Borut, Executive Director, National League of Cities
William H. Hansell, Executive Director, International City/County Management Association
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