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CENTER FOR GOVERNMENTAL STUDIES Northern Illinois University

issue: *Big Changes Around the Corner for Public Sector Financial Reporting: How Illinois Can Prepare and Take A Leadership Role*

By Shannon N. Sohl, CPA, MPA, Ph.D.

Editor's Note: This issue of *Policy Profiles* has been prepared by the Center for Governmental Studies at Northern Illinois University to alert Illinois state and local governments about the status of the state's financial reporting and the need to adapt to, and expand upon, recently passed federal legislation that requires all governments to make significant changes in the way they account for, and report on, their revenues, expenditures, assets, and liabilities.

This *Policy Profiles* is intended to *forewarn* Illinois governments so that they can take steps to be *forearmed* in a timely manner. It is important to note that, as this is being written, work is accelerating and the whole process is in a state of flux. Illinois leaders should not delay addressing this evolving situation.

On May 9, 2014, President Barack Obama signed into law the Digital Accountability and Transparency Act, also known as the DATA Act, which had been passed unanimously by both houses of the United States Congress.

The implementation of this law could affect the way nearly all government and non-profit agencies in the United States report their finances. According to the Data Transparency Coalition, a Washington, DC-based industry organization supporting the passage and successful implementation of the DATA Act, this legislation will revolutionize federal spending:

By replacing inaccessible documents with standardized, searchable data—freely accessible to all—the DATA Act will create better accountability for taxpayers and citizens; improve federal management by illuminating waste and fraud; and reduce compliance costs by automating the creation of reports by grantees and contractors.¹

The act will begin to impact Illinois state and local government agencies in 2015, and the changes in accounting methods and procedures mandated by the act are to be operational for all affected agencies during calendar year 2018.

What is the purpose of the DATA Act?

The primary purpose of the act is to provide the United States' first legislative mandate for data transparency,² requiring all governmental and non-profit service agencies' financial information to be made fully transparent. It seeks to accomplish this in two ways:

- *2015 is the year that the new federal DATA Act will start to impact Illinois state and local governments, and all other agencies using federal dollars.*
- *Many governments and private agencies will probably be required to use a new, standardized system of financial reporting.*
- *Work is now ongoing in Illinois—in part by Northern Illinois University—to modernize governmental financial reporting.*
- *Listed herein are actions that should be taken now by Illinois leaders and state and local government agencies.*

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1. Common terms and definitions.

By requiring all governmental financial documents and reports to use financial terminology that has a common, precise definition, and all such information be compiled and analyzed using the same definitions and prescribed procedures, so that all such reports can be readily compared, interpreted, and understood. Thus public sector agencies will be required to define and use terminology in the same specified way, making all analyses and comparisons within and among reports fully comparable.

2. Machine-readable.

By requiring that all government data and analyses, produced as specified in #1 above, be published and searchable on the internet using a nonproprietary, platform-independent format where they will be available to all who wish to access them.

In other words, this act could require that terms like “fiscal administration expenditures” and “public safety expenses” will everywhere have the same precise meaning, and thus they will provide fully comparable financial information on the same kinds of activities. Common definitions will make such reports easier to understand by other government agencies, legislative and administrative policymakers, and the public at-large.

Why is the DATA Act moving government towards a more modern system for producing and consuming financial information?

The current systems used to produce financial information in Illinois and elsewhere are neither efficient nor effective. Updating individual reporting systems, or contracting with professionals whenever

changes must be made to account for new regulations, is time-consuming and costly. These systems are also difficult and expensive for consumers of the information. Today, financial information is reported in ways that are only readable and understandable by people, not machines, and which cannot be integrated with reports from other governments for analytical purposes. As a result, analysis is cumbersome and time-consuming. Machines cannot be used to transform reports into usable data.

Not only is this existing process inherently inconsistent and error prone, but submitted data often contain errors and use a multitude of definitions for basic financial terms. As a result, such data ultimately cannot be compared or trusted. Moreover, existing reports focus on expenditures rather than on performance, and emphasize current balances while neglecting to provide information on future needs. The result is a system that is inefficient, inaccurate, and a poor return on the investment of time and resources.

Additionally, individual governments and non-profit agencies have too much discretion in the way they report their finances. *For example, in a brief review of one Illinois county’s municipalities, Northern Illinois University’s Center for Governmental Studies found 26 different ways that expenditures under the heading “General Government Expenditures” were being reported by city and village governments.*

Furthermore, with the data in PDF format, each municipality’s data must be extracted manually for analytical purposes and this makes comparisons very difficult and error prone. Consumers, including local taxpayers, experience long delays—on average, about six months after the close

of the fiscal year—before getting this information. This delay, along with the time and effort needed to extract the data manually, makes analyses of the information both difficult and unreliable.

THE CURRENT STATE OF GOVERNMENTAL FINANCIAL REPORTING IS INEFFICIENT AND LIMITS TAXPAYERS’ AND STAKEHOLDERS’ ABILITY TO MAKE DATA-DRIVEN DECISIONS.

The foundation of a successful, open digital reporting solution will be the adoption of a single, collaboratively, and centrally maintained data dictionary or taxonomy plus a clear set of principles and policies to govern its consistent design and use. Such a single accounting taxonomy will be the key to creating meaningful, usable digitized financial information.

What kinds of government financial actions will be affected by the Act?

The DATA Act directs the federal government—and ultimately all state and local governments and non-profit agencies seeking or using federal funds—to standardize the way they record and report all of the financial data covering their operations.

This means that all financial data maintained by these organizations must be categorized, retained, and made available to the public in a yet-to-be-determined, standardized format. This covers the financial data related to all of their operations, including all budgeting activities, government spending, financial management, payments, purchasing, borrowing, contracting, and financial assistance. Thus the act will affect all financial aspects of government grants and contracts.

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How will the Act affect Illinois governments?

While the act does not explicitly compel state and local governments, in Illinois and elsewhere, to comply with the accounting definitions and stipulations required by it, the reasonable expectation is that all agencies that are currently receiving any federal assistance will be required to use the federal accounting terminology, analytical methods, and reporting processes that are mandated by Congress for the federal government itself. Such an expectation is based on the premise that those doing financial business with the federal government will be expected to comply with federal requirements.

Thus, given the huge number of public and private organizations that benefit from federal financial assistance, the accounting standards to be established under the act are expected to be quickly adopted by *all* those agencies directly or indirectly using federal monies.

This means all state government agencies filing a single audit report, including state-supported universities, penal institutions, health agencies, agricultural organizations, and foundations, may have to follow the soon-to-be-announced federal reporting standards and methods. So, too, will private organizations, including businesses, colleges and universities, health agencies, private foundations, and other privately owned agencies receiving or using federal funds and filing a single audit report.³

What are the likely benefits of implementing the DATA Act?

A uniform system of financial record keeping and reports will improve efforts to enhance both the operations of individual governments and the ability of multiple governments to work together to solve common problems.

A UNIFORM SYSTEM OF FINANCIAL RECORD KEEPING WILL IMPROVE OPERATIONS AND THE ABILITY TO WORK TOGETHER TO SOLVE PROBLEMS.

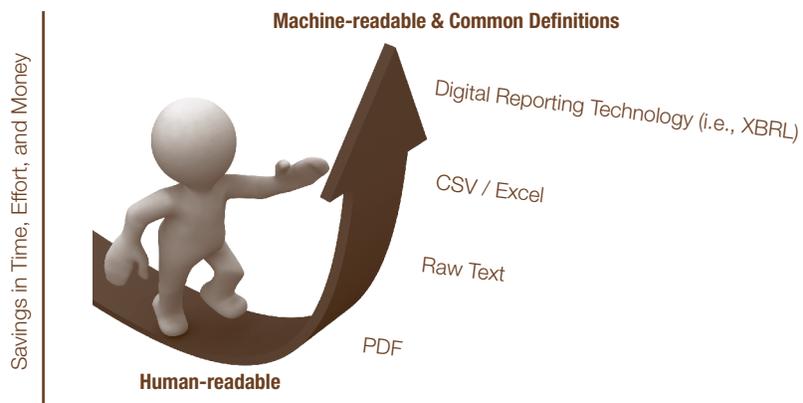
The transparency and accountability measures likely to result from the DATA Act directives may also produce substantial cost savings for Illinois governments when addressing their bond ratings. Such directives may also generate additional savings by facilitating some much needed, but difficult structural changes in the ways that agencies are organized and operating.

The diagram in **Figure 1** demonstrates graphically the comparison between the accounting taxonomy (a word used by accountants to refer to the definitions and classification systems used to report accounting information) most widely used by governments today, and the taxonomy that is expected to be used by all governments under the changes caused by the DATA Act.⁴

- The low point of the arrow in the figure reflects the methods now most commonly used by governments and other public agencies to record their financial information, summarize it, and then compile it into a report. It is the most costly option now available in terms of time, effort, and money, and it also produces reports which are the hardest for the public to understand and the most difficult for analysts to use to evaluate the financial consequences of policy options.
- The option at the highest end of the arrow—the option most likely to be favored by accounting changes made in response to the new DATA Act—is the easiest and cheapest option, produces reports most easily understood by the public, and is the most likely to produce error free analyses of the financial implications of policy options.

But to achieve these benefits, Illinois governments and public service agencies must be aware of, and hopefully participate in, the process of developing the directives needed to accomplish the Act's objectives.

Figure 1: Digital Financial Reporting Leads to Increased Savings of Time, Effort, and Money



Reasoning in Capability, Meta Data, Context, and Knowledge Representation

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Beyond the DATA Act, Illinois needs to make a strategic and coordinated effort to further increase the:

- Efficiency,
- Effectiveness, and
- Ultimate transparency and accountability of all government spending in the state.

In the interest of good government (i.e., of governmental accountability to the citizens), to assure that the state's governments report their financial activities in the form most easily understood by the state's residents and voters, and to cut the long term cost of managing government finances, *the state's political leaders must act, and act now*. State representatives and financial professionals should get involved in the process, now and going forward, to help set the new taxonomies and procedures that will be used in the future.

It is up to the state's political leaders to assure that Illinois governments and citizens will receive the kinds of benefits graphically portrayed in **Figure 2**.

Why is collaboration so important?

It is not in anyone's interest to have competing sets of standards governing accounting systems. Widespread confusion will result—indeed, has resulted—when the federal government has one taxonomy and other organizations use different taxonomies. There needs to be a common taxonomy for the use of organizations—like the federal, state, and local governments, and the organizations that work with them—so that these agencies can interact with a minimum amount of miscommunication and misunderstanding of each other. Further, this information is most useful to the most people if it is digitized.

Figure 3 illustrates the many producers and consumers of local government financial reports in just one level of government in just one state: Illinois local government. So, for example, if the new federal standards are different from the standards required by the State of Illinois or by such agencies as the Municipal Securities Rulemaking Board (MSRB), then governments and public agencies which must report fiscal disclosures to bond rating agencies, lenders, financial institutions, and so forth, will—and do—face a nearly insurmountable

Figure 3: There Are Numerous Beneficiaries of Digitized Data Who Should Collaborate on a National Solution

Who Benefits?

The U.S. has approximately 90,000 local governments of which a large portion provide financial reports to all or some combination of the following stakeholders:

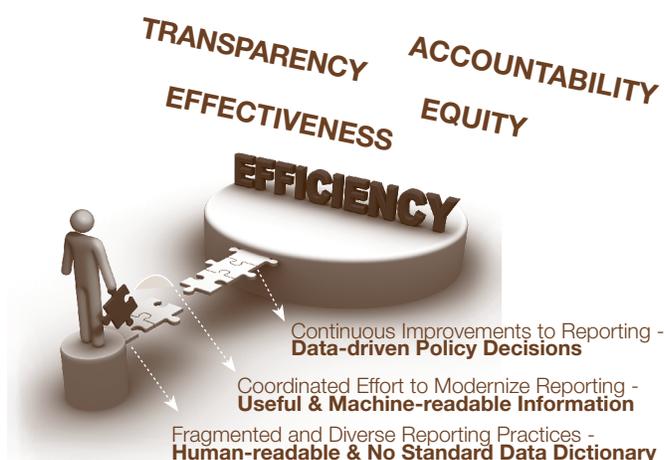
- States and Local Governments
- Municipal Securities Rulemaking Board
- Bond Rating Agencies
- Auditors
- Investors and Financial Institutions
- U.S. Census Bureau
- Government Finance Officers Association
- Government Accounting Standards Board
- Elected Officials
- Citizens
- Federal Audit Clearinghouse (Single Audits)
- Other Regulators, Professional Associations, and Consumers

task in meeting the differing data format requirements set forth by the different oversight agencies.

Illinois has an opportunity to be a part of the process that will lead to the development and adoption of such a single, standardized governmental accounting taxonomy. Illinois' state policymakers—the governor and the leaders of the Illinois Senate and House of Representatives—are the ones who can make it happen. Actions they should take include:

- Keeping Illinois informed about the changes being made in Washington;
- Giving Illinois a voice, and a leadership role, in the design of the changes now being made in Washington;

Figure 2: Benefits to Be Gained by Modernizing Public Sector Financial Management



- Assuring any such changes are compatible with Illinois’ needs and resources;
- Positioning Illinois to play a role in designing the monumental changes in the way American government will operate in the future; and
- Establishing mechanisms that allow consumers and producers of financial information to coordinate jointly a solution that will best serve all concerned agencies and stakeholders.

The two goals in this process are: 1) to modernize the taxonomy used to record, store, report, and analyze the data which describes the financial affairs of governmental and non-profit public service agencies in Illinois; and 2) to do so in a way that gives equal weight to servicing the public’s need for information as well as the needs of other stakeholders to reduce the burden and costs of financial reporting.

The kind of balance depicted in **Figure 4** has not always been a priority in the way public sector financial administration has been handled in the past; it must be achieved and maintained in the future.

How should Illinois legislators respond?

Illinois’ legislators have an opportunity to become involved in the DATA Act and pursue enhancements above and beyond the requirements of the Act. For instance, they can be sure that other entities, such as those referenced in Figure 3, are included in the development of a national solution to increase transparency and accountability of governmental spending and reporting as well as efficient and affordable solutions for the consumers and producers of fiscal data.

The DATA Act will drive change for recipients of federal funding. Illinois’ legislators should work to implement standard changes and technology, including those not mandated by the Act, for the largest return on investment.

What has been accomplished to date?

Northern Illinois University’s Center for Governmental Studies (CGS) and Rutgers University have jointly formed a public-private partnership with leading accounting experts experienced in current and recent major accounting taxonomy efforts such as the ongoing SEC/FASB⁵ program supporting the US-GAAP⁶

Taxonomy. This effort has engaged local government leaders, regulators, practitioners, professional organizations, legislators, interest groups, and university researchers in a joint effort to improve governmental accounting procedures. It is currently seeking solutions that will work for the entire nation.

However, an undertaking of this magnitude is not feasible without the support of elected and appointed officials at the state and local levels. While the NIU-Rutgers partnership will leverage the insights gained from similar efforts at developing accounting taxonomies that will work for the entire nation, and will maximize the benefits from a standardized data reporting format, insight and support from Illinois’ governmental leadership is needed to complete and sustain a new reporting model.

Related initiatives unfolding in Illinois involve multiple stakeholders working to drive improvements in service standards and economics through changes in governmental structure. A part of this effort are attempts to bring other stakeholders to the table who will help design and secure approval of financial reporting reforms that can be used nationally to promote and expedite needed changes in the way governments operate.

Simplification of complex governmental procedures and structures will further contribute to financial reporting reform. The majority of the nearly 7,000 local governments in Illinois currently maintain their own accounting and reporting systems and staff, and they are all subject to the audit process. Increased standardization of financial administration—entering, compiling, analyzing, and reporting of data—will (a) increase both efficiency and effectiveness in operations and (b) enable Illinois stakeholders to monitor more accurately the fiscal performance and service standards of the state and local

Figure 4: Striking the Right Balance for Illinois’ Success



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government agencies. This, in turn, will help policy makers make better decisions when calibrating a suitable structure of government.

What actions could be taken now?

With passage of the DATA Act, technology companies throughout the United States and around the world are rushing to develop software to support financial reporting products that will allow government and non-profit agencies to submit their financial reporting data electronically.

It is imperative these product developers use a single, standard set of financial definitions to enable the data to be aggregated, compared, and analyzed across different tools and databases.

Based on its work on this topic to date, the NIU researchers recommend that the following steps be taken to enhance Illinois' public sector financial reporting system to the level at which it will stand as a model for the rest of the nation.

- **Establishing a diverse committee** representing both consumers and producers of governmental financial information to recommend how best to overhaul the reporting process for Illinois' governmental and public sector agencies. The mandate of such a committee should be to standardize the reporting concepts and make the information machine-readable and more timely.

This committee should work with other states and across all layers of Illinois government, including state offices (especially the Department of Revenue, the Comptroller's Office, and the state's budgeting offices); local governments; other stakeholders such as auditors, investors, the Governmental Accounting Standards Board (GASB), the Government

Finance Officers Association (GFOA), the Municipal Securities Rulemaking Board; the federal government's Office of Management and Budget and the U.S. Treasury Department, to ensure each change being considered would be beneficial and in compliance with legal regulations and professional standards or practices.

- **Designing and Implementing a Data Repository** that would align the structure of the financial database with the needs of consumers and producers and allow them to access the data on demand in an open environment.
- **Maintaining the Repository** by designating a new or existing office which would provide continuing professional council and advice to the Data Repository as it works to maintain and update the financial management tools (i.e., taxonomy/data dictionary and central repository) needed to keep the system up-to-date and meet changes in needs and requirements that will occur over time. Instead of each local government having to update its own system every time GASB issues a new reporting standard, local governments and agencies would report through tools that already have been updated by the new compliance office. This is similar to the way in which TurboTax continuously updates its system with each year's changes in tax codes.

The group with maintenance and oversight responsibility of the taxonomy and repository should be charged with:

1. **Optimizing the Data:** Providing the digitized data to produce required periodic, standard reports such as the Fiscal Responsibility Report Card, Illinois Report Card - School Data, Tax Increment Financing (TIF) reports, and budgets, linking

these to other data for analysis (e.g., economic impact of investments in enterprise zones and Tax Increment Finance (TIF) districts, parcel-based cost assessments, the cost of crime).

2. **Analyzing the Data:** Incorporating standard performance indicators such as liquidity and debt ratios used by the Office of the Comptroller's Warehouse.
3. **Providing Education and Training:** Offering ongoing training to users and consumers in an on-line environment or workshop setting to increase both financial literacy and the use of new reporting tools.
4. **Continuously Improving the System as Needed:** Implementing feedback mechanisms to improve the reporting model and improving access to data, particularly to assessments that could lead to more cost savings for the state.
5. **Moving Toward a National Financial Reporting System:** Continuing to partner with other states, the federal government, and other stakeholders to adopt a national standard taxonomy and repository that enables consumers such as bond rating agencies and the MSRB to extract data more efficiently. Cash in Illinois should be reported in the same manner as cash in Texas.

Now that the new DATA Act has been passed, policymakers around the country will be discussing how to best formulate and implement the new data standards and technological tools for reporting financial data. Illinois has much to contribute to these discussions and is well-positioned to take a leadership role.

Who will benefit from updating public sector accounting practices?

Three types of benefits will result from efforts to modernize and improve governmental and non-profit agency financial management methods. First, taxpayers will benefit from the long-term cost savings that can result from replacing present financial management practices, with their roots in the 19th century, with modern day, digitalized financial record keeping and reporting. Second, all layers and units of government will benefit from the increases in efficiencies and the accuracy of the data presented. Third, citizens, elected officials, the financial services sector, professional organizations, interest groups, and researchers will benefit by investing in a state that is more efficiently and effectively run.

Illinois can lead the change in expanding the Act to all local government reporting.

A single, collaboratively developed set of meanings for accounting terms, together with a single digitalized system for maintaining and reporting data, will be the key for creating meaningful, broadly understood, and easily compared government financial reports. It will allow all participants in the governing process to draw important conclusions from the full breadth of related, comparable information.

The process has already been started through the work being performed by the public-private partnership involving NIU's Center for Governmental Studies and Rutgers University as well as leading accountants, software providers, and domain experts.

What is needed now is participation in the project by Illinois' state and local government leadership to assure that the changes ultimately forthcoming will best meet the needs of Illinois.

With such a public/private collaboration fully operative in Illinois, a standard system of accounting and reporting can be developed which will assure greater government transparency, financial accountability, and public sector financial decision-making in Illinois by providing the context needed to transform relevant financial information into actionable knowledge.

Endnotes

¹www.datacoalition.org/press-releases/statement-by-data-transparency-coalition-executive-director-hudson-hollister-on-president-obamas-decision-to-sign-data-act/. For a full description of what the DATA Act requires, see the Data Transparency Coalition's (DTC's) website www.datacoalition.org/what-is-data-transparency/data-act/

²www.datacoalition.org

³What is known in accounting terms as an A-133.

⁴The term "taxonomy" will continue to be used in this report to refer to the "definitions and classification systems used to report accounting information." NOTE: The term "data dictionary" - used later in this *Policy Profiles* - will be interchangeably used with the term "taxonomy" in this report.

⁵Security and Exchange Commission/Financial Accounting Standards Board

⁶United States - Generally Accepted Accounting Principles

About the Author

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