

# Accounting for Governmental & Nonprofit Entities

Nineteenth Edition

Jacqueline L. Reck, Ph.D.,  
CPA

*James E. and C. Ellis Rooks  
Distinguished Professor in Accounting  
University of South Florida*

Suzanne L. Lowensohn,  
Ph.D., CPA, CGMA

*Associate Professor of Accounting  
University of Vermont*

Daniel G. Neely, Ph.D., CPA

*Associate Professor of Accounting  
University of Wisconsin–Milwaukee*

**Mc  
Graw  
Hill**



# ACCOUNTING FOR GOVERNMENTAL & NONPROFIT ENTITIES, NINETEENTH EDITION

Published by McGraw Hill LLC, 1325 Avenue of the Americas, New York, NY 10121. Copyright © 2022 by McGraw Hill LLC. All rights reserved. Printed in the United States of America. Previous editions © 2019, 2016, and 2013. No part of this publication may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written consent of McGraw Hill LLC, including, but not limited to, in any network or other electronic storage or transmission, or broadcast for distance learning.

Some ancillaries, including electronic and print components, may not be available to customers outside the United States.

This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 LWI 24 23 22 21

ISBN 978-1-260-80995-4 (bound edition)

MHID 1-260-80995-1 (bound edition)

ISBN 978-1-2640-7118-0 (loose-leaf edition)

MHID 1-264-07118-3 (loose-leaf edition)

Portfolio Manager: *Elizabeth Eisenhart*

Product Developers: *Kristina Dehlin (Agate)*

Marketing Manager: *Claire McLemore*

Content Project Managers: *Fran Simon, Jamie Koch*

Buyer: *Susan K. Culbertson*

Designer: *David W. Hash*

Content Licensing Specialist: *Jacob Sullivan*

Cover Image: ©*Arina Habich / Alamy Stock Photo*

Compositor: *SPi Global*

All credits appearing on page or at the end of the book are considered to be an extension of the copyright page.

## Library of Congress Cataloging-in-Publication Data

Names: Reck, Jacqueline L., author. | Lowensohn, Suzanne L., author. | Neely, Daniel G., author.

Title: Accounting for governmental & nonprofit entities / Jacqueline L. Reck, Suzanne L. Lowensohn, Daniel G. Neely.

Description: Nineteenth Edition. | Dubuque : McGraw-Hill Education, 2021. | Revised edition of the authors' Accounting for governmental & nonprofit entities, [2019]

Identifiers: LCCN 2020042090 | ISBN 9781260809954 (hardcover)

Subjects: LCSH: Finance, Public—Accounting. | Nonprofit organizations—Accounting. | Nonprofit organizations—United States—Accounting.

Classification: LCC HJ9733 .W48 2021 | DDC 657/.825—dc23

LC record available at <https://lcn.loc.gov/2020042090>

The Internet addresses listed in the text were accurate at the time of publication. The inclusion of a website does not indicate an endorsement by the authors or McGraw-Hill Education, and McGraw-Hill Education does not guarantee the accuracy of the information presented at these sites.

[mheducation.com/highered](http://mheducation.com/highered)



# About the Authors

## Jacqueline L. Reck

Serves as the associate dean of financial management and academic affairs for the Muma College of Business and is the James E. and C. Ellis Rooks Distinguished Professor in Accounting at the University of South Florida. She received a BS degree from North Dakota State University, BS and MAcc degrees from the University of South Florida, and her PhD from the University of Missouri–Columbia. She is a certified public accountant (Florida).

Dr. Reck worked for state government for several years before joining academia. Currently, she is active in several professional associations and works with budget and financial management at the Muma College of Business. In addition to teaching government and not-for-profit accounting, Dr. Reck has served on the Governmental Accounting Standards Advisory Council and currently serves on the Financial Reporting Model Task Force. She has presented workshops and sessions on government and not-for-profit accounting. Dr. Reck has received several teaching and research awards and has chaired or served on several doctoral dissertation committees.

Dr. Reck has published articles in *Journal of Accounting and Public Policy*; *Journal of Governmental and Nonprofit Accounting*; *Research in Governmental and Nonprofit Accounting*; *Journal of Public Budgeting, Accounting and Financial Management*; and the *Journal of Information Systems*, among others. She joined as an author on the 14th edition.

## Suzanne L. Lowensohn

Is an associate professor of Accounting at the University of Vermont. She received BS and MAcc degrees from the University of South Florida and her PhD from the University of Miami. She is a certified public accountant (Florida) and a chartered global management accountant.

Dr. Lowensohn has served on the Governmental Accounting Standards Board Intangible Issues, Fiduciary Implementation Guide, and Disclosure Framework Task Forces and Comprehensive Implementation Guide Advisory Committee; on the Government Finance Officers Association Special Review Executive Committee; on the Colorado Society of Certified Public Accountants Governmental Issues Committee; on the AICPA FARS Content Subcommittee; on the AICPA Government Performance and Accountability Committee; and as president of the Government and Non-profit Section of the American Accounting Association. Prior to joining academia, she worked for KPMG and performed numerous governmental audits.

Professor Lowensohn has published articles in *Contemporary Accounting Research*; *Journal of Accounting and Public Policy*; *Journal of Governmental and Nonprofit Accounting*; *Research in Governmental and Nonprofit Accounting*; *Accounting in Europe*; and *Journal of Public Budgeting, Accounting and Financial Management*, among others. She joined as an author on the 16th edition.

## Daniel G. Neely

Is an associate professor of Accounting at the University of Wisconsin–Milwaukee. He received BBA and MPA degrees from the University of Texas at Austin and his PhD from the University of Houston. He is a certified public accountant (Texas).

Dr. Neely worked in public accounting for several years before joining academia. Currently, he is active in professional associations and nonprofit organizations. In addition to teaching not-for-profit accounting, Dr. Neely serves on the Editorial Board of the *Journal of Governmental and Nonprofit Accounting* and *Nonprofit Voluntary Sector Quarterly*. He has served on the FASB NFP Financial Statements Project Resource Group, on the FASB NFP Other Financial Communications Resource Group, and as president of the Government and Nonprofit Section of the American Accounting Association.

Professor Neely has published articles in *Contemporary Accounting Research*; *Journal of Business Ethics*; *Journal of Accounting and Public Policy*; *Journal of Governmental and Nonprofit Accounting*; *Accounting Horizons*; *Issues in Accounting Education*; *Journal of Accounting Education*; *Nonprofit Voluntary Sector Quarterly*; and *Journal of Public Budgeting, Accounting and Financial Management*, among others. He joined as an author on the 18th edition.

# Preface

For more than 60 years, *Accounting for Governmental & Nonprofit Entities* has led the market in governmental accounting. It is a comprehensive government and not-for-profit accounting text, written for students who will be auditing and working in public and not-for-profit sector entities. Originally published in 1951 and written by Professor R. M. Mikesell, this book—and the many subsequent editions revised by Professors Leon Hay, Earl Wilson, Susan Kattelus, Jacqueline Reck, Suzanne Lowensohn, and Daniel Neely—have given generations of instructors and students a comprehensive knowledge of the specialized accounting and financial reporting practices of government and not-for-profit organizations, as well as an understanding of how those organizations can better meet the information needs of a diverse set of financial statement users and decision makers. The vision of the early authors continues to be reflected in this 19th edition, and their strategy of providing a large and innovative set of instructional support materials prepared and tested in the classroom by the authors continues to be a guiding principle today. The current author team brings to this edition their extensive experience teaching government and not-for-profit courses as well as insights gained from their professional experience, scholarly writing, and professional activities. The result is a relevant and accurate text that includes the most effective instructional tools.

## ORGANIZATION AND CONTENT

The 19th edition of *Accounting for Governmental & Nonprofit Entities* is separated into three parts: Part One covers state and local governments (Chapters 2 through 9), Part Two focuses on accountability for public funds (Chapters 10 through 12), and Part Three examines not-for-profit organizations (Chapters 13 through 16) and the federal government (Chapter 17). Chapter 1 continues to form a broad foundation for the more detailed material in Chapters 2 through 17. The order of the chapters is the same as the last edition. The chapters are ordered to facilitate a variety of courses and formats used by adopters of the text. For example, a course focused on state and local governments could cover Chapter 1 and Parts One and Two, while a course focused on not-for-profit organizations could cover Chapter 1 and Parts Two and Three. Part Two is a bridge between the public and not-for-profit sectors that includes accountability topics (e.g., financial analysis, auditing, and budgeting) applicable to all types of entities that receive public funds.

## KEY CHANGES IN THIS EDITION

With the 19th edition, we are pleased to continue to expand options available under McGraw Hill's Connect and LearnSmart educational technology systems. Connect is a digital teaching and learning platform for homework completion and review that helps improve student performance over a variety of critical outcomes while aiding instructor grading and assessment efficiency. LearnSmart is an adaptive study tool that helps identify specific topics and learning objectives individual students need to study.

As always, readers can count on this edition to include authoritative changes from the Governmental Accounting Standards Board, Financial Accounting Standards Board, Federal Accounting Standards Advisory Board, American Institute of Certified Public

Accountants, Office of Management and Budget, Internal Revenue Service, and Government Accountability Office. Update bulletins will be provided periodically on the text website as new authoritative statements are issued.

Since publication of the 18th edition, **important** changes affecting accounting, financial reporting, and auditing for government and not-for-profit organizations have occurred, which include

- The Government Accountability Office issued revised Generally Accepted Governmental Auditing Standards in 2018 that impact audits of entities receiving federal funding.
- The Auditing Standards Board issued new standards regarding audit reports and auditor responsibility.
- The Financial Accounting Standards Board issued *Accounting Standards Update No. 2018-08* that clarifies whether a transaction should be recorded as a contribution or an exchange transaction.

The following is a list of the chapter by chapter changes that have been incorporated into the text, which includes the preceding items.

- Throughout the textbook additional headers have been inserted and more bulleted formats have been used to make reading easier on an electronic platform.
- When a transaction is mentioned in two chapters the associated journal entry is now shown in both chapters in response to user feedback.
- All chapters contain substantive revisions to the end of chapter materials.
- Chapter 3 contains additional information and journal entries related to other financing sources and uses.
- Chapter 4 now includes sales taxes in addition to property taxes. An end of chapter problem requiring preparation of statements from revenue and appropriations ledgers has been added to support this process in the Smithville and Bingham projects.
- Chapter 5 adjusts language related to debt issuances for acquisition of capital assets. In response to textbook user comments the section on bond premiums, discounts and accrued interest has been modified to better reflect the relationship between the capital project fund and the debt service fund.
- Chapter 7 streamlines the discussion of internal service fund administration.
- Chapter 8 modifies the section on custodial funds and provides new journal entries for this section of the chapter. The focus is on the tax custodial fund with less emphasis on other types of funds as suggested by the textbook users.
- Chapter 9 modifies the sections for Defining the Reporting Entity and Reporting Component Units. A section on XBRL has been added under Other Financial Reporting Issues and Topics.
- Chapter 10 modifies the section on Analyzing Government Financial Statements.
- Chapter 11 contains extensive changes. The section on Financial Audits by Independent CPAs has been significantly reorganized and modified. The section on Government Auditing Standards has been updated for the new standards and includes a new Illustration 11–5.
- Chapter 12 addresses two new topics under Managerial Tools to Improve Performance: data analytics and enterprise risk management. Total Quality Management and Customer Relationship Management have been removed. Budget examples from the City of San Diego have been added.

- Chapter 14 contains numerous changes. The most significant change is found in Accounting for NFP Organizations. This section incorporates changes to reflect ASU 2018-08, which clarifies when a transaction is considered a contribution versus and exchange transaction.
- Ch. 15 and Ch. 16 incorporate FASB ASC Topic 606 in reference to exchange transactions.
- Chapter 17 addresses the newest concept statement, *SFFAC No. 8*, Federal Financial Reporting.

## NEW DATA ANALYTICS COVERAGE

Several notable improvements have been made in this edition of the text. Information has been added in Chapters 1 and 9 that introduces “**big data**” and technology use in governments. As part of this introduction, **data analytics exercises** have been provided within Connect that relate to various chapters in the government and not-for-profit sections of the text. A short version of the City of Bingham has been added. The authors have also expended the test bank, adding additional questions in every chapter.

## NEW SHORTENED VERSION OF CITY OF BINGHAM

This edition continues to feature two comprehensive and effective computerized practice sets, the City of Bingham and the City of Smithville. As with the prior edition, a short version of the City of Smithville practice set and a *new* short version of the City of Bingham are available for those instructors who wish a less comprehensive case. Both practice sets are available within Connect.

## INNOVATIVE PEDAGOGY

For state and local government accounting, the authors have found that *dual-track* accounting is an effective approach in showing the juxtaposition of government-wide and fund financial statements in GASB’s integrated model of basic financial statements. It allows students to see that each transaction has an effect on the fund financial statements (that are designed to show fiscal compliance with the annual budget), on the government-wide financial statements (that demonstrate accountability for operational performance of the government as a whole), or both. This approach better serves students who will design and use accounting information systems to allow information to be captured once and used for several purposes. Accounting for federal agencies as well as nongovernmental, not-for-profit entities closely parallels this approach as traditional fund accounting may be appropriate for keeping track of resources with restricted purposes, but citizens and donors also need to see the larger picture provided by the entity as a whole.

Governments will continue to prepare fund-based statements throughout the year and convert to accrual-based government-wide statements at the end of the year until they invest in information systems that can deliver real-time information for decision making. We want students to think beyond being transaction-bookkeepers and aspire to design and use the systems that will make government-wide financial information available when managers and citizens need it. The City of Bingham and City of



Smithville Continuous Computerized Problems are teaching tools that develop these skills and perspective. The authors feel so strongly that this general ledger software tool helps students understand the material that we again provide it with the text. Students have enthusiastically told us that they like “learning by doing” and that these continuous computerized problems helped them to understand the concepts in the book.

## TARGET AUDIENCE

The text continues to be best suited for senior and graduate accounting majors who plan to sit for the certified public accountant (CPA) exam and then audit government or not-for-profit entities. Public administration and other students who plan to provide financial management or consulting services to government and not-for-profit entities report that the text provides a more comprehensive set of competencies than traditional public budgeting texts. Students in not-for-profit management education programs find that the coverage of accounting, financial reporting, auditing, taxation, and information systems for both government and not-for-profit entities provides the exposure they need to work across disciplines and sectors. Finally, students preparing for the certified government financial manager (CGFM) or the certified public finance officer (CPFO) exam also will find Chapters 1 through 12 useful. We encourage all students who use this text to consider the challenges and rewards of careers in public service—in federal, state, and local governments as well as not-for-profit organizations.

## ADDITIONAL INSTRUCTOR AND STUDENT RESOURCES

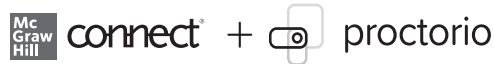
The Connect Instructor Library is a repository for additional resources to improve student engagement in and out of class. You can select and use any asset that enhances your lecture. The following ancillary materials are prepared by the authors to ensure consistency and accuracy and are available in the Instructor Resources within the Connect Library, and via the Additional Student Resources within the eBook. The Connect Instructor Library includes

- Instructor’s Guide and Solutions Manual.
- PowerPoint lecture presentations.
- Test bank (including TestGen).

The Test Bank includes true/false, multiple-choice, and discussion questions/problems at varying levels of difficulty. All test bank questions are also available in a flexible electronic test generator. The answers to all questions are given, along with a rating of the level of difficulty, chapter learning objective met, Bloom’s taxonomy question type, and the AACSB knowledge category.

- The City of Bingham and City of Smithville Continuous Computerized Problems—general ledger practice sets, downloadable from Connect.
- The City of Bingham and City of Smithville Instructor’s Version software, providing guidance for instructors, solution data files, and solution page image (.pdf) files for all required financial statements, schedules, and reports.
- Data sets and data-related problems for both governments and not-for-profits.

## REMOTE PROCTORING & BROWSER-LOCKING CAPABILITIES



New remote proctoring and browser-locking capabilities, hosted by Proctorio within Connect, provide control of the assessment environment by enabling security options and verifying the identity of the student.

Seamlessly integrated within Connect, these services allow instructors to control students' assessment experience by restricting browser activity, recording students' activity, and verifying students are doing their own work.

Instant and detailed reporting gives instructors an at-a-glance view of potential academic integrity concerns, thereby avoiding personal bias and supporting evidence-based claims.

## WRITING ASSIGNMENT

Available within McGraw Hill Connect® and McGraw Hill Connect® Master, the Writing Assignment tool delivers a learning experience to help students improve their written communication skills and conceptual understanding. As an instructor you can assign, monitor, grade, and provide feedback on writing more efficiently and effectively.

## ROGER CPA



McGraw Hill has partnered with Roger CPA Review, a global leader in CPA Exam preparation, to provide students a smooth transition from the accounting classroom to successful completion of the CPA Exam. While many aspiring accountants wait until they have completed their academic studies to begin preparing for the CPA Exam, research shows that those who become familiar with exam content earlier in the process have a stronger chance of successfully passing the CPA Exam. Accordingly, students using these McGraw Hill materials will have access to sample CPA Exam Multiple-Choice questions and Task-Based Simulations from Roger CPA Review, with expert-written explanations and solutions. All questions are either directly from the AICPA or are modeled on AICPA questions that appear in the exam. Task-Based Simulations are delivered via the Roger CPA Review platform, which mirrors the look, feel, and functionality of the actual exam. McGraw Hill and Roger CPA Review are dedicated to supporting every accounting student along their journey, ultimately helping them achieve career success in the accounting profession. For more information about the full Roger CPA Review program, exam requirements, and exam content, visit [www.rogercpareview.com](http://www.rogercpareview.com).

# The Dual-Track Accounting Approach

The GASB reporting model requires government-wide, accrual-based financial statements to provide information that goes beyond the familiar fund accounting information. Analysts use government-wide “big picture” information in performance analysis, and some council members find that, relative to fund accounting information, accrual-based statements are better suited to demonstrate accountability for interperiod equity. For example, these statements provide the information necessary to explore critical questions such as, Has the government shifted the liability for current services to future generations? However, to date, governmental accounting software vendors have not provided governments with systems that can directly produce government-wide financial statements on the required accrual basis, particularly on an interim basis, such as monthly.

The dual-track approach helps students understand how two different sets of accounting records are used to collect financial data as transactions occur. One set of records collects information using the short-term measurement focus and near-cash basis of accounting traditionally used in governmental fund accounting. This set of records includes a chart of accounts, general journal, general ledger, trial balances, and financial statements for each fund. The other set of records collects the same underlying information using a long-term measurement focus similar to that used by business; that is, the accrual basis of accounting. The second set

of records assists in preparing statements for governmental activities and business-type activities. Each time a transaction is presented, we illustrate or explain what, if any, effect it will have on the fund and governmental activities record.

The text does illustrate the reclassification approach in Chapter 9 because that approach is used in practice by most governments. Governments that continue to release only fund financial information throughout the year and must then convert (or reclassify) the data to government-wide information for the purposes of the financial statement preparation and year-end audit are not as accountable or transparent as governments that make GAAP-based information available throughout the year.

Governments, even small ones, are complex entities, and there is no easy approach to learning the external governmental financial model. But the authors believe that the dual-track approach is conceptually superior to the reclassification approach in that it gives students the tools to understand “why” and “how” financial statements are prepared and used. A greater conceptual understanding of governmental financial statements also makes it easier for students to understand the reclassification approach when it is encountered. The dual-track pedagogy can help students see the short- and long-term effects of the decisions made by government managers and oversight bodies from the perspective of all stakeholders.

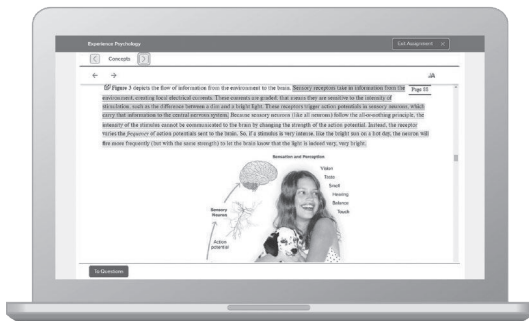


## Instructors: Student Success Starts with You

### Tools to enhance your unique voice

Want to build your own course? No problem. Prefer to use our turnkey, prebuilt course? Easy. Want to make changes throughout the semester? Sure. And you'll save time with Connect's auto-grading too.

**65%**  
Less Time  
Grading



Laptop: McGraw Hill; Woman/dog: George Doyle/Getty Images

### Study made personal

Incorporate adaptive study resources like SmartBook® 2.0 into your course and help your students be better prepared in less time. Learn more about the powerful personalized learning experience available in SmartBook 2.0 at [www.mheducation.com/highered/connect/smartbook](http://www.mheducation.com/highered/connect/smartbook)

### Affordable solutions, added value



Make technology work for you with LMS integration for single sign-on access, mobile access to the digital textbook, and reports to quickly show you how each of your students is doing. And with our Inclusive Access program you can provide all these tools at a discount to your students. Ask your McGraw Hill representative for more information.

Product: iStock/Getty Images

### Solutions for your challenges



A product isn't a solution. Real solutions are affordable, reliable, and come with training and ongoing support when you need it and how you want it. Visit [www.supportateverystep.com](http://www.supportateverystep.com) for videos and resources both you and your students can use throughout the semester.

Checkmark: iStock/Getty Images

**SUPPORT <sup>AT</sup>**  
**every step**

## Students: Get Learning that Fits You

### Effective tools for efficient studying

Connect is designed to make you more productive with simple, flexible, intuitive tools that maximize your study time and meet your individual learning needs. Get learning that works for you with Connect.

### Study anytime, anywhere

Download the free ReadAnywhere app and access your online eBook or SmartBook 2.0 assignments when it's convenient, even if you're offline. And since the app automatically syncs with your eBook and SmartBook 2.0 assignments in Connect, all of your work is available every time you open it. Find out more at [www.mheducation.com/readanywhere](http://www.mheducation.com/readanywhere)

***"I really liked this app—it made it easy to study when you don't have your text-book in front of you."***

- Jordan Cunningham,  
Eastern Washington University



Calendar: owattaphotos/Getty Images

### Everything you need in one place

Your Connect course has everything you need—whether reading on your digital eBook or completing assignments for class, Connect makes it easy to get your work done.

### Learning for everyone

McGraw-Hill works directly with Accessibility Services Departments and faculty to meet the learning needs of all students. Please contact your Accessibility Services Office and ask them to email [accessibility@mheducation.com](mailto:accessibility@mheducation.com), or visit [www.mheducation.com/about/accessibility](http://www.mheducation.com/about/accessibility) for more information.

Top: Jenner Images/Getty Images, Left: Hero Images/Getty Images, Right: Hero Images/Getty Images



# Connect Features

## CONNECT END-OF-CHAPTER MATERIAL

Connect helps students learn more efficiently by providing feedback and practice material when they need it, where they need it. Connect grades homework automatically and gives immediate feedback on any questions students may have missed. The extensive assignable, gradable end-of-chapter content includes a new multi-tab design for easier navigation for select exercises. A selection of auto-graded static and algorithmic exercises is available for each chapter within Connect.

The City of Castleton's General Fund had the following post-closing trial balance at June 30, 2019, the end of its fiscal year:

	Debits	Credits
Cash	\$ 438,000	
Taxes Receivable-Delinquent	591,000	
Allowance for Uncollectible Delinquent Taxes		\$ 197,000
Interest and Penalties Receivable	27,000	
Allowance for Uncollectible Interest and Penalties		11,960
Inventory of Supplies	16,900	
Vouchers Payable		156,500
Due to Federal Government		67,490
Deferred Inflows of Resources-Unavailable		419,000
Revenues		
Fund Balance-Nonspendable-Inventory of Supplies		16,900
Fund Balance-Unassigned		204,130
	<u>\$1,072,900</u>	<u>\$1,072,900</u>

- Record the effect of the following transactions on the General Fund and governmental activities for the year ended June 30, 2020.
- Record in general journal form entries to close the budgetary and operating statement accounts in the General Fund only. Do not close the governmental activities accounts.
- Prepare a General Fund balance sheet as of June 30, 2020.
- Prepare a statement of revenues, expenditures, and changes in fund balance for the year ended June 30, 2020. Do not prepare the government-wide financial statements.

Complete this question by entering your answers in the tabs below.

Required A Required B Required C Required D

Prepare a General Fund balance sheet as of June 30, 2020.

CITY OF CASTLETON	
General Fund Balance Sheet	
As of June 30, 2020	
Assets	
Cash	

## MCGRAW-HILL EDUCATION CUSTOMER EXPERIENCE GROUP CONTACT INFORMATION

At McGraw-Hill Education, we understand that getting the most from new technology can be challenging. That's why our services don't stop after you purchase our products. You can contact our Product Specialists 24 hours a day to get product training online. Or you can search the knowledge bank of Frequently Asked Questions on our support website. For Customer Support, call 800-331-5094, or visit [www.mhhe.com/support](http://www.mhhe.com/support). One of our Technical Support Analysts will be able to assist you in a timely fashion.

## ASSURANCE OF LEARNING READY

Many educational institutions today are focused on the notion of *assurance of learning*, an important element of some accreditation standards. *Accounting for Governmental & Nonprofit Entities* is designed specifically to support your assurance of learning initiatives with a simple, yet powerful solution.

Each test bank question for *Accounting for Governmental & Nonprofit Entities* maps to a specific chapter learning objective listed in the text. You can use Connect to easily query for learning outcomes/objectives that directly relate to the learning objectives for your course. You then can use the reporting features of Connect to aggregate student results in a similar fashion, making the collection and presentation of assurance of learning data simple and easy.

## AACSB STATEMENT

McGraw-Hill Education is a proud corporate member of AACSB International. Understanding the importance and value of AACSB accreditation, *Accounting for Governmental & Nonprofit Entities* recognizes the curricula guidelines detailed in the AACSB standards for business accreditation by connecting selected questions in the test bank to the eight general knowledge and skill guidelines in the AACSB standards.

The statements contained in *Accounting for Governmental & Nonprofit Entities* are provided only as a guide for the users of this textbook. The AACSB leaves content coverage and assessment within the purview of individual schools, the mission of the school, and the faculty. While *Accounting for Governmental & Nonprofit Entities* and the teaching package make no claim of any specific AACSB qualification or evaluation, within the Test Bank to accompany *Accounting for Governmental & Nonprofit Entities* we have labeled selected questions according to the eight general knowledge and skill areas.



# City of Bingham and City of Smithville Continuous Computerized Problems

**Note: The City of Bingham and City of Smithville computerized problems can be found within Connect, in the Instructor Library and in the Additional Student Resources for students.**

A great way to understand the GASB financial reporting model is to be actively engaged in learning through these “hands-on” continuous problems for small governmental entities. The City of Bingham and City of Smithville web supplement is general ledger software in which students record transactions in the appropriate general journals of each city. Transaction analysis is the first and most important step in the accounting cycle of any organization. After journal entries have been recorded, the software conveniently posts changes to all accounts in general and to subsidiary ledgers. From this point, students can preview trial balances, export them to a Microsoft Excel file, and then prepare financial statements from those data.

This instructional supplement substantially aids students’ learning by requiring them to decide whether each transaction has an effect on the *fund financial statements*, the *government-wide financial statements*, or both. The City of Bingham and City of Smithville are built on the *dual-track approach* described in a previous section and in the textbook. Students can apply the conceptual framework that connects the government-wide financial statements (that report on the flow of total economic resources of the government using the accrual basis of accounting) and the fund financial statements (that report on the flow of current financial resources using the modified accrual or near-cash basis of accounting).

sends out property tax bills for the year, this transaction is recorded in the General Fund general journal because it impacts the governmental funds statement of revenues, expenditures, and changes in fund balance and in the governmental activities general journal because it has an impact on the government-wide statement of activities. Within each practice set, you can easily toggle among the journals for each fund and governmental activity. Drop-down menus make it easy to decide which revenue account should be increased or decreased, as the chart of accounts is embedded in the software. Journal entries must balance before one can proceed. When the government records its budget or encumbers items related to purchase orders, however, these journal entries affect only the governmental funds. Budgetary account titles are available for selection in the governmental funds general journals but not in the governmental activities general journal because funds, not governmental activities, capture information to show compliance with the short-term, legally approved budget. Conversely, depreciation expense of general capital assets is recorded only in the general journal of governmental activities because the accrual basis of accounting captures and matches the cost of using up the utility of capital assets with the time period in which the assets generate revenues.

## STUDENTS

Several examples are provided here to show how the software facilitates learning. When a government

## INSTRUCTORS

This software can be used in several ways. You can project it each day as part of the classroom experience and discuss transactions that are keyed to the



chapter under discussion. Depending on your objectives, you can require a small set of the transactions be recorded for each fund or governmental activity or you can assign either of the full problems as a semester-long case. Regardless of how you choose to use the cases, we recommend that students work on the City of Bingham or City of Smithville problem as they are studying the related chapter in the text and turn in each chapter as they go along. You may find that small student work groups provide an efficient way for students to learn from each other.

We continue to be encouraged by our students' positive reaction as they *learn by doing* the City of Bingham and City of Smithville Continuous Computerized Problems.

## DATA ANALYTICS PROBLEMS

**Note: The data sets and the Data Analytics problems can be found in Connect, in the Instructor Resources Library and in the Additional Student Resources for students.**

An increasing emphasis on data analysis in accounting and by governments has resulted in the provision of supplemental problems that can be used in conjunction with various government and not-for-profit chapters of the text. To accompany the supplemental problems, a **government data set** and a **not-for-profit data** set have been provided for use with the supplemental problems. As indicated in the instructions, the problems are designed to be completed using an Excel spreadsheet.

# Acknowledgments

We are thankful for the encouragement, suggestions, and counsel provided by many instructors, professionals, and students in writing this book. They include the following professionals and educators who read portions of this book and previous editions in various forms and provided valuable comments and suggestions:

**Kimball Adams**

*City of Largo, Florida*

**Jack Armitage**

*University of Nebraska—Omaha*

**Terry D. Balkaran**

*Queens College*

**Kelli A. Bennett**

*City and County of Denver*

**Irfan Bora**

*Rutgers University*

**Michael Crawford**

*Crawford & Associates*

**William Delia**

*Pima Community College*

**Lynda Dennis**

*University of Central Florida*

**Erin Dischler**

*Milwaukee Area Technical College*

**Ruth W. Epps**

*Virginia Commonwealth University*

**Renee Flasher**

*Ball State University*

**Karen Foust**

*Tulane University*

**Michael Gallagher**

*University of Maryland University College*

**Jacob Gatlin**

*Athens State University*

**Marina Grau**

*Houston Community College*

**Debra Gula**

*University of South Florida*

**Richard Hawk**

*Horry Georgetown Technical College*

**Laurie Henry**

*Old Dominion University*

**Kristen Hockman**

*University of Missouri—Columbia*

**Andrew C. Holman**

*RitzHolman CPAs*

**Larita Killian**

*IUPUI—Columbus Center*

**Randall Kinnersley**

*Western Kentucky University*

**Leon Korte**

*University of South Dakota*

**Barbara Lippincott**

*Bella Vista, Arkansas*

**Sarah Macy**

*Town of Essex/Village of Essex Junction, Vermont*

**Allen McConnell**

*University of Northern Colorado*

**Dean Mead**

*Governmental Accounting Standards Board*

**Michele Nix**

*City of Columbia, Missouri*

**Suzanne Ogilby**

*California State University, Sacramento*

**Susan Paris**

*Nova Southeastern University*

**Lisa Parker**

*Governmental Accounting Standards Board*

**Veronica Paz**

*Indiana University of Pennsylvania*

**Wendy Potratz**

*University of Wisconsin—Oshkosh*

**Annette Pridgen***Jackson State University***Linda Ragland***University of New Hampshire***Walter A. Robbins***University of Alabama***Gail Sanderson***Lebanon Valley College***Mark Sutter***El Paso, Texas***Relmond P. Van Daniker***Association of Government Accountants***Cindy Vance***Shepherd University***Scott Hsu-dze Wang***Baker College***Shunda Ware***Atlanta Technical College***Tammy Waymire***Middle Tennessee State University***Earl R. Wilson***University of Missouri—Columbia*

Dr. Reck thanks her family for their support and dedicates her work to the memory of Albert for the inspiration he will always provide. Dr. Lowensohn would like to express appreciation to her family—Tom, Grant, and Tara—for their support and patience and to her friend and colleague Dr. Laurence Johnson for his professional guidance. Dr. Neely thanks his family—Xiaoting, Stephanie, and Ann—for their support and encouragement.

Although we are extremely careful in checking the text and end-of-chapter material, it is possible that errors and ambiguities remain in this edition. As readers encounter such, we urge them to let us know, so that corrections can be made. We also invite every user of this edition who has suggestions or comments about the material in the chapters to share them with one of the authors, either by regular mail or e-mail. The authors will continue the service of issuing Update Bulletins to adopters of this text that describe changes after the book is in print. These bulletins can found in the Instructor Resources tab in the Connect Library.

*Dr. Jacqueline L. Reck**Lynn Pippenger School of Accountancy**University of South Florida**4202 East Fowler Avenue, BSN 3403**Tampa, FL 33620**jreck@usf.edu**Dr. Suzanne L. Lowensohn**The University of Vermont**Grossman School of Business**55 Colchester Avenue**Burlington, VT 05405**Suzanne.Lowensohn@uvm.edu**Dr. Daniel G. Neely**The University of Wisconsin—Milwaukee**Sheldon B. Lubar School of Business**3202 North Maryland Avenue**Milwaukee, WI 53211**neely@uwm.edu*

# Brief Contents

## Preface vi

- 1 Introduction to Accounting and Financial Reporting for Government and Not-for-Profit Entities 1

## PART ONE

### State and Local Governments

- 2 Principles of Accounting and Financial Reporting for State and Local Governments 21
- 3 Governmental Operating Statement Accounts; Budgetary Accounting 71
- 4 Accounting for Governmental Operating Activities—Illustrative Transactions and Financial Statements 117
- 5 Accounting for General Capital Assets and Capital Projects 179
- 6 Accounting for General Long-Term Liabilities and Debt Service 219
- 7 Accounting for the Business-type Activities of State and Local Governments 271
- 8 Accounting for Fiduciary Activities—Custodial and Trust Funds 322
- 9 Financial Reporting of State and Local Governments 372

## PART TWO

### Accountability for Public Funds

- 10 Analysis of Government Financial Performance 423
- 11 Auditing of Government and Not-for-Profit Organizations 456

- 12 Budgeting and Performance Measurement 497

## PART THREE

### Accounting and Financial Reporting for Not-for-Profit Organizations and the Federal Government

- 13 Not-for-Profit Organizations—Regulatory, Taxation, and Performance Issues 536
- 14 Accounting for Not-for-Profit Organizations 568
- 15 Accounting for Colleges and Universities 623
- 16 Accounting for Health Care Organizations 668
- 17 Accounting and Reporting for the Federal Government 708

## GLOSSARY 754

## GOVERNMENT AND NOT-FOR-PROFIT ORGANIZATIONS 768

## INDEX 773

# Table of Contents

## Preface vi

## Chapter 1

### Introduction to Accounting and Financial Reporting for Government and Not-for-Profit Entities 1

Welcome to Government and Not-for-Profit Accounting 1

Distinguishing Government and Not-for-Profit Organizations 2

*What Are Government and Not-for-Profit Organizations?* 2

*Distinguishing Characteristics of Government and Not-for-Profit Organizations* 3

Sources of Financial Reporting Standards 4

Objectives of Financial Reporting 5

Overview of Financial Reporting for State and Local Governments, the Federal Government, and Not-for-Profit Organizations 7

*Financial Reporting of State and Local Governments* 7

*Financial Reporting of the Federal Government* 10

*Financial Reporting of Not-for-Profit Organizations (NFPs)* 11

Expanding the Scope of Accountability Reporting 12

Overview of Chapters 2 Through 17 13

*GASB Principles, Standards, and Financial Reporting* 13

*Accountability for Public Funds* 13

*Not-for-Profit Organizations and the Federal Government* 13

A Caveat 14

Key Terms 14

Questions 15

Cases 15

Exercises and Problems 16

## PART ONE

### State and Local Governments

## Chapter 2

### Principles of Accounting and Financial Reporting for State and Local Governments 21

Conceptual Framework—Providing Useful Financial Reports 22

*Concepts Statement No. 1* 22

*Concepts Statement No. 3* 23

*Concepts Statement No. 4* 23

*Concepts Statement No. 6* 24

Activities of Government 25

Financial Reporting Model 26

*Government-wide Financial Statements* 26

*Fund Financial Statements* 28

Fund Reporting 31

*Fund Categories* 32

*Classification of Governmental Fund Balances* 35

*Major Fund Reporting* 36

*Fund Reporting of Budgetary Information* 38

Summary of Government-wide and Fund Characteristics 38

Appendix A: Illustrative Financial Statements from the City and County of Denver, Colorado 40

Appendix B: Summary Statement of Government Accounting and Financial Reporting Principles 55

Key Terms 59

Selected References 60

Questions 60

Cases 60

Exercises and Problems 63

## Chapter 3

### Governmental Operating Statement Accounts; Budgetary Accounting 71

Reporting of Expenses and Revenues at the Government-wide Level 72

*Reporting Direct and Indirect Expenses* 72

*Program Revenues and General Revenues* 74

*Reporting Special Items and Transfers* 75

Structure and Characteristics of the General Fund and Other Governmental Funds 76

*Governmental Fund Balance Sheet and Operating Statement Accounts* 76

Reporting Budgeted and Actual Results 79

## Terminology and Classification for Budgetary and Operating Statement Accounts 82

*Classification of Appropriations and Expenditures* 82

*Classification of Estimated Revenues and Revenues* 85

*Classification of Estimated Other Financing Sources (Uses) and Other Financing Sources (Uses)* 90

## Budgetary Accounting 90

*Recording the Budget* 91

*Budgetary Control of Revenues* 92

*Budgetary Control of Encumbrances and Expenditures* 93

*Revision of the Budget* 96

*Closing Budgetary Accounts* 97

*Accounting for Allotments* 98

## Concluding Remarks 98

## Appendix A: Accounting for Public School Systems 99

## Appendix B 101

## Key Terms 102

## Selected References 102

## Questions 102

## Cases 103

## Exercises and Problems 105

## Chapter 4

### Accounting for Governmental Operating Activities—Illustrative Transactions and Financial Statements 117

#### Illustrative Case 118

*Financial Statement Comparisons* 118

#### Dual-Track Accounting Approach 120

#### Illustrative Journal Entries 121

*Recording the Budget* 121

*Encumbrances and Purchasing Transactions* 121

*Payment of Liabilities* 124

*Payrolls and Payroll Taxes* 124

*Accounting for Property Taxes* 125

*Other Revenues* 131

*Tax Anticipation Notes* 132

#### Special Topics 134

*Revision of the General Fund Budget* 134

*Receipt of Goods Ordered in a Prior Year* 135

*Exchange Transactions with Proprietary Funds* 136

*Accounting for Supplies* 140

*Adjusting Entries* 142

*Pre-closing Trial Balance* 142

*Closing Entries* 143

*Reclassification of Fund Balances* 144

*General Fund Financial Statements* 145

#### Special Revenue Funds 148

*Accounting for Operating Grants* 148

*Financial Reporting* 149

#### Interfund Activity 151

*Intra- versus Inter-activity Transactions (Government-wide Level)* 152

#### Permanent Funds 153

*Budgetary Accounts* 153

*Illustrative Case* 153

#### Appendix A: Concepts and Rules for Recognition of Revenues and Expenses (or Expenditures) 156

#### Appendix B: Interim Financial Reporting 159

#### Key Terms 160

#### Selected References 161

#### Questions 161

#### Cases 162

#### Exercises and Problems 164

## Chapter 5

### Accounting for General Capital Assets and Capital Projects 179

#### Accounting for General Capital Assets 180

*Required Disclosures about Capital Assets* 181

*Classification of General Capital Assets* 182

*General Capital Assets Acquired under Lease Agreements* 186

*Costs Incurred after Acquisition* 188

*Reduction of Cost or Asset Disposal* 189

*Asset Impairments and Insurance Recoveries* 190

*Service Concession Arrangements* 191

#### Capital Projects Funds 191

*Illustrative Transactions—Capital Projects*

*Funds* 192

*Illustrative Financial Statements for a Capital Projects Fund* 198

*Alternative Treatment of Residual Equity or Deficits* 198

*Bonds Sold at a Premium or Discount* 198

*Retained Percentages* 200

*Claims and Judgments Payable* 201

*Bond Anticipation Notes Payable* 201

*Investments* 202

<i>Multiple-Period and Multiple-Project Funds</i>	203
<i>Capital Projects Financed by Special Assessments</i>	204
<i>Financial Reporting for Capital Projects Funds</i>	205
Key Terms	205
Selected References	205
Questions	205
Cases	206
Exercises and Problems	208

## Chapter 6

### Accounting for General Long-Term Liabilities and Debt Service 219

General Long-Term Liabilities	219
<i>Accounting for Long-Term Liabilities</i>	220
<i>Long-Term Liability Disclosures</i>	221
Debt Service Funds	229
<i>Number of Debt Service Funds</i>	229
<i>Use of General Fund to Account for Debt Service</i>	230
<i>Budgeting for Debt Service</i>	230
<i>Types of Bonds</i>	231
<i>Accounting for Bonds</i>	232
<i>Financial Reporting</i>	241
Special Topics Related to Long-Term Liabilities	242
<i>Accounting for Bond Premiums</i>	242
<i>Accounting for Accrued Interest</i>	244
<i>Bond Issue Costs</i>	245
<i>Bond Anticipation Notes</i>	245
<i>Use of Debt Service Funds to Record Lease Payments</i>	245
<i>Debt Service Accounting for Special Assessment Debt</i>	247
<i>Accounting for Debt Refunding</i>	249
<i>Valuation of Debt Service Fund Investments</i>	251
<i>Deposit and Investment Disclosures</i>	252
Other Long-Term Liabilities	253
<i>Compensated Absences</i>	253
<i>Pollution Remediation Obligations</i>	253
<i>Claims and Judgments</i>	254
Key Terms	254
Selected References	254
Questions	254
Cases	255
Exercises and Problems	259

## Chapter 7

### Accounting for the Business-type Activities of State and Local Governments 271

Proprietary Funds	272
<i>Financial Reporting Requirements</i>	272
Internal Service Funds	275
<i>Illustrative Case—Supplies Fund</i>	275
<i>Illustrative Statements Using Supplies Fund</i>	281
<i>External Financial Reporting of Internal Service Funds</i>	283
<i>Dissolution of an Internal Service Fund</i>	284
<i>Special Topics Associated with Internal Service Funds</i>	284
Enterprise Funds	287
Water Utility Funds	288
<i>Current and Accrued Assets</i>	288
<i>Restricted Assets</i>	289
<i>Utility Plant</i>	290
<i>Current Liabilities</i>	290
<i>Liabilities Payable from Restricted Assets</i>	290
<i>Long-Term Liabilities</i>	291
<i>Net Position</i>	291
<i>Illustrative Case—Water Utility Fund</i>	292
<i>Illustrative Statements Using Water Utility Fund</i>	297
<i>External Financial Reporting of Enterprise Funds</i>	301
Appendix: Special Topics in Accounting for the Business-type Activities of State and Local Governments	302
Key Terms	306
Selected References	306
Questions	306
Cases	307
Exercises and Problems	310

## Chapter 8

### Accounting for Fiduciary Activities—Custodial and Trust Funds 322

Identifying Fiduciary Activities	323
Custodial Funds	323
<i>Tax Custodial Funds</i>	324
<i>Special Assessment Debt Service Custodial Funds</i>	329
<i>“Pass-through” Custodial Funds</i>	329
<i>Financial Reporting of Custodial Funds</i>	330



Trust Funds	331
Investment & Private-Purpose Trust Funds	331
<i>Investment Pools</i>	331
<i>Private-Purpose Trust Funds</i>	340
Illustrative Financial Statements	341
Pension Trust Funds	343
<i>General Characteristics of Government Pension Plans</i>	343
<i>Required Financial Reporting for Defined Benefit Pension Plans</i>	345
<i>Illustrative Transactions for a Defined Benefit Pension Plan</i>	350
<i>Employer's Pension Accounting</i>	353
<i>Employer Recording and Reporting of Pension Expenditure/Expense</i>	355
Other Postemployment Benefits (OPEB)	355
Termination Benefits	356
Appendix A: Managing Investments	356
Key Terms	358
Selected References	358
Questions	358
Cases	359
Exercises and Problems	360

## Chapter 9

### Financial Reporting of State and Local Governments 372

The Government Reporting Entity	372
<i>Defining the Financial Reporting Entity</i>	373
<i>Reporting Component Units</i>	374
<i>Reporting by Other Government Organizations</i>	377
Government Financial Reports	378
<i>Interim Financial Reports</i>	378
<i>Annual Financial Reports</i>	379
Preparation of Basic Financial Statements	382
<i>Fund Financial Statements</i>	388
<i>Required Reconciliations</i>	390
<i>Intra-entity Transactions</i>	391
Other Financial Reporting Issues and Topics	393
<i>XBRL and Governments</i>	393
<i>Popular Reporting</i>	393
<i>Special Purpose Frameworks</i>	394
<i>International Accounting Standards</i>	395
Appendix A: Converting Accounting Information from the Modified Accrual to the Accrual Basis of Accounting	395

Appendix B: Management's Discussion and Analysis (MD&A) – City and County of Denver	398
Key Terms	408
Selected References	409
Questions	409
Cases	409
Exercises and Problems	414

## PART TWO

### Accountability for Public Funds

#### Chapter 10

#### Analysis of Government Financial Performance 423

The Need to Evaluate Financial Performance	423
Government Financial Performance Concepts	424
<i>Financial Position and Financial Condition</i>	425
<i>Economic Condition</i>	425
Internal Financial Trend Monitoring	426
<i>Environmental Factors</i>	427
<i>Organizational Factors</i>	431
<i>Financial Factors</i>	432
Analyzing Government Financial Statements	432
<i>Analyzing Governmental Fund Financial Statements</i>	432
<i>Analyzing Government-wide Financial Statements</i>	434
Use of Benchmarks to Aid Interpretation	436
<i>Sources of Government Financial Data</i>	440
<i>Electronic Municipal Market Access</i>	440
<i>Credit Analyst Models</i>	440
Key Terms	442
Selected References	442
Questions	442
Cases	442
Exercises and Problems	445

#### Chapter 11

#### Auditing of Government and Not-for-Profit Organizations 456

Financial Audits by Independent CPAs	457
<i>Generally Accepted Auditing Standards</i>	457
<i>The Audit Process</i>	458
<i>The Audit Report</i>	461
<i>Audit Requirements for NFPs</i>	463



Government Auditing Standards	465
<i>Types of Audits and Engagements</i>	465
<i>GAGAS Financial Audits</i>	466
<i>Ethics and Independence</i>	469
Single Audits	473
<i>History of the Single Audit</i>	473
<i>Determining Who Must Have a Single Audit</i>	474
<i>Single Audit Requirements</i>	476
<i>Selecting Programs for Audit</i>	478
<i>Reports Required for the Single Audit</i>	481
<i>Other Single Audit Requirements</i>	483
Special Topics Related to Audits of Governments and Not-for-Profits	483
<i>Single Audit Quality</i>	483
<i>The Impact of the Sarbanes-Oxley Act of 2002</i>	485
<i>Audit Risk and Available Guidance</i>	486
Key Terms	486
Selected References	486
Questions	487
Cases	487
Exercises and Problems	491

## **Chapter 12**

### **Budgeting and Performance Measurement 497**

Objectives of Budgeting in the Public Sector	498
<i>Compliance with Laws</i>	498
<i>Communicate Performance Effectiveness</i>	499
Budgeting Approaches	501
<i>Line-Item Budgeting</i>	501
<i>Performance Budgeting</i>	501
<i>Program Budgeting</i>	502
<i>Entrepreneurial Budgeting</i>	503
Budgeting Process in a State or Local Government	503
<i>Budgeting Government Appropriations</i>	503
<i>Budgeting Government Revenues</i>	506
<i>Budgeting Capital Expenditures</i>	507
<i>Budgeting Cash Receipts</i>	507
<i>Budgeting Cash Disbursements</i>	508
<i>Budget Documents</i>	510
Integration of Planning, Budgeting, and Performance Measurement	510
<i>Service Efforts and Accomplishments (SEA)</i>	513

### **Managerial Tools to Improve Performance 517**

<i>Data Analytics</i>	517
<i>Enterprise Risk Management</i>	517
<i>Activity-Based Costing</i>	518
<i>Balanced Scorecards</i>	519
Appendix: Budget and Cost Issues in Grant Accounting	520
Key Terms	523
Selected References	524
Questions	524
Cases	524
Exercises and Problems	527

## **PART THREE**

### **Accounting and Financial Reporting for Not-for-Profit Organizations and the Federal Government**

#### **Chapter 13**

### **Not-for-Profit Organizations—Regulatory, Taxation, and Performance Issues 536**

Defining the Not-for-Profit Sector	537
State Regulation	538
<i>Not-for-Profit Incorporation Laws</i>	540
<i>Licenses to Solicit Contributions or for Other Purposes</i>	540
<i>Taxes</i>	541
<i>Lobbying and Political Activity</i>	541
Federal Regulation	541
<i>Tax-Exempt Status</i>	541
<i>Unrelated Business Income Tax</i>	546
<i>Excessive Benefits Received by Officers</i>	548
<i>Reorganization and Dissolution</i>	549
Governance	549
<i>Incorporating Documents</i>	549
<i>Board Membership</i>	550
Benchmarking and Performance Measures	550
<i>Financial Performance Measures</i>	552
<i>Nonfinancial Performance Measures</i>	553
Key Terms	555
Selected References	555
Questions	555
Cases	556
Exercises and Problems	558

**Chapter 14****Accounting for Not-for-Profit Organizations 568**

Gaap for Nongovernmental NFP Organizations 569

*Determining Whether an NFP Organization Is a Government* 569

Financial Reporting 570

*Statement of Financial Position* 570

*Statement of Activities* 572

*Statement of Cash Flows* 574

*Reporting of Expenses by Nature and Function* 575

*Notes to the Financial Statements* 575

Accounting for NFP Organizations 577

*Revenues and Gains* 577

*Support* 578

*Types of Support* 579

*Accounting for Expenses* 584

*Accounting for Assets* 585

Consolidations and Combinations 587

*Consolidations* 587

*Combinations* 588

Illustrative Transactions—Not-for-Profit Organizations 589

*End-of-the-Year Adjusting Journal Entries* 594

*End-of-the-Year Reclassification Journal Entries* 595

*End-of-the-Year Closing Journal Entries* 597

Appendix: Optional Fund Accounting 602

Key Terms 603

Selected References 603

Questions 604

Cases 604

Exercises and Problems 608

**Chapter 15****Accounting for Colleges and Universities 623**

Accounting and Financial Reporting Standards 624

*Private Colleges and Universities* 625

*Public Colleges and Universities* 625

Reporting and Accounting Issues 629

*Statement of Net Position or Financial Position* 629

*Operating Statements* 632

*Statement of Cash Flows* 636

*Segment Reporting* 637

Illustrative Transactions for Private Colleges and Universities 637

*Adjusting Entries* 642

*Closing Entries* 643

Planned Giving 644

*Endowments* 644

*Split-Interest Agreements* 645

*Uniform Prudent Management of Institutional Funds Act* 648

Other Accounting Issues 649

*Performance Measures* 649

*Auditing Colleges and Universities* 651

*Federal Financial Assistance* 652

*Related Entities* 652

Key Terms 653

Selected References 653

Questions 653

Cases 654

Exercises and Problems 658

**Chapter 16****Accounting for Health Care Organizations 668**

GAAP for Health Care Providers 670

Reporting and Accounting Issues 670

*Balance Sheet or Statement of Net Position* 671

*Operating Statement* 673

*Statement of Changes in Net Assets* 680

*Statement of Cash Flows* 680

Illustrative Case for a Not-for-Profit Health Care Organization 683

Other Health Care Issues 690

*Related Entities* 690

*Auditing* 691

*Taxation and Regulatory Issues* 691

*Patient Protection and Affordable Care Act* 692

*Prepaid Health Care Plans* 692

*Continuing Care Retirement Communities* 693

*Financial and Operational Analysis* 693

Key Terms 695

Selected References 695

Questions 695

Cases 696

Exercises and Problems 698

**Chapter 17****Accounting and Reporting for the Federal Government 708**

Federal Government Financial Management Structure 709

*Comptroller General* 711

*Secretary of the Treasury* 711

*Director of the Office of Management and Budget* 711

*Director of the Congressional Budget Office* 712

Generally Accepted Accounting Principles for the Federal Government 712

*Hierarchy of Accounting Principles and Standards* 713

Conceptual Framework 713

*Objectives* 714

*Reporting Entity* 714

*Management's Discussion and Analysis (MD&A)* 715

*Intended Audience* 715

*Elements and Recognition Criteria* 716

*Communicating Information* 716

*Measurement of Elements after Initial Recording* 716

*Federal Financial Reporting* 716

Funds Used in Federal Accounting 716

*General Fund* 717

*Special Funds* 717

*Revolving Funds* 717

*Trust Funds* 717

*Trust Revolving Funds* 718

*Deposit Funds* 718

Required Financial Reporting—U.S. Government-wide 718

Required Financial Reporting—Government Agencies 720

*Agency Head Message* 721

*Management's Discussion and Analysis (MD&A)* 721

*Annual Performance Reports (APR)* 721

*Annual Financial Statements (AFR)* 721

*Other Accompanying Information* 729

Dual-Track Accounting System 729

*Illustrative Transactions and Entries* 732

*Adjusting Entries* 738

*Illustrative Financial Statements* 739

Summary of Accounting and Reporting for Federal Government Agencies 743

Key Terms 743

Selected References 744

Questions 744

Cases 745

Exercises and Problems 746

**Glossary 754****Government and Not-for-Profit Organizations 768****Index 773**

# Accounting for Governmental & Nonprofit Entities

# Chapter One



Arina Habich/Alamy  
Stock Photo

## Introduction to Accounting and Financial Reporting for Government and Not-for-Profit Entities

### Learning Objectives

After studying this chapter, you should be able to:

- 1-1 Identify and explain the characteristics that distinguish government and not-for-profit entities from for-profit entities.
- 1-2 Identify the authoritative bodies responsible for setting financial reporting standards for (1) state and local governments, (2) the federal government, and (3) not-for-profit organizations.
- 1-3 Contrast and compare the objectives of financial reporting for (1) state and local governments, (2) the federal government, and (3) not-for-profit organizations.
- 1-4 Explain the minimum requirements for general purpose external financial reporting for state and local governments and how they relate to comprehensive annual financial reports.
- 1-5 Identify and describe the required financial statements for the federal government.
- 1-6 Identify and describe the required financial statements for not-for-profit organizations.

### WELCOME TO GOVERNMENT AND NOT-FOR-PROFIT ACCOUNTING

**Welcome to the new world of accounting for government and not-for-profit organizations!** Initially, you will likely find it challenging to understand the many new terms and concepts introduced. Additionally, if you are like most readers, you will question at the outset why government and not-for-profit organizations use accounting and financial reporting practices that are different from those used by for-profit entities.

As you read this first chapter of the text, the reasons for the differences between government and not-for-profit accounting and for-profit accounting should become apparent.

## 2 Accounting for Governmental & Nonprofit Entities

Specifically, government and not-for-profit organizations serve entirely different purposes in society than do business entities. Because such organizations are largely financed by taxpayers, donors, and others who do not expect benefits proportional to the resources they provide, management has a special duty to be accountable for how resources are used in providing services. Thus, the need for managers to be accountable to citizens, creditors, oversight bodies, and others has played a central role in shaping the accounting and reporting practices of government and not-for-profit organizations.

This first chapter will give you a basic conceptual understanding of the unique characteristics of government and not-for-profit organizations and how their accounting and financial reporting concepts and practices differ from those of for-profit organizations. By the time you finish subsequent chapters assigned for your course, you should have an in-depth practical knowledge of government and not-for-profit accounting and financial reporting.

## DISTINGUISHING GOVERNMENT AND NOT-FOR-PROFIT ORGANIZATIONS

### LO 1-1

Identify and explain the characteristics that distinguish government and not-for-profit entities from for-profit entities.

### What Are Government and Not-for-Profit Organizations?

Government and not-for-profit organizations are vast in number and range of services provided. In the United States, governments exist at the federal, state, and local levels and serve a wide variety of functions. The most recent census of governments reports that there are 90,075 local governments, in addition to the federal government and 50 state governments. The local governments consist of 3,031 counties, 19,495 municipalities, 16,253 towns and townships, 12,754 independent school districts, and 38,542 other special district governments that derive their power from state governments.<sup>1</sup>

States, counties, municipalities (e.g., cities, towns, and villages), and townships are **general purpose governments**—governments that provide a wide range of services to their residents (such as police and fire protection; sanitation; construction and maintenance of streets, roads, and bridges; and culture and recreation).

Independent school districts, public colleges and universities, and special districts are **special purpose governments**—governments that provide only a single function or a limited number of functions (such as education, drainage and flood control, irrigation, soil and water conservation, fire protection, and water supply). Similar to general purpose governments, special purpose governments are provided the power by state laws to levy and collect taxes and to raise revenues from nontax sources to finance the services they provide.

Not-for-profit organizations also exist in many forms and serve many different functions in society. These include private colleges and universities, various kinds of community service and health care organizations, certain libraries and museums, professional and trade associations, fraternal and social organizations, and religious organizations. According to the National Center for Charitable Statistics website, there were approximately 1.56 million not-for-profit organizations registered with the Internal Revenue Service in 2015.<sup>2</sup>

<sup>1</sup> U.S. Department of Commerce, Bureau of the Census, *Table 2. Local Governments by Type and State: 2017*, [www.census.gov/data/tables/2017/econ/gus/2017-governments.html](http://www.census.gov/data/tables/2017/econ/gus/2017-governments.html), accessed February 1, 2020.

<sup>2</sup> Brice S. McKeever, *The Nonprofit Sector in Brief* (Washington, DC: The Urban Institute, January 3, 2019), <https://nccs.urban.org/project/nonprofit-sector-brief>, accessed December 9, 2019.

## Distinguishing Characteristics of Government and Not-for-Profit Organizations

Government and not-for-profit organizations differ in important ways from business organizations. An understanding of how these organizations differ from business organizations is essential to understanding the unique accounting and financial reporting principles that have evolved for government and not-for-profit organizations.

In its *Statement of Financial Accounting Concepts No. 4*, the **Financial Accounting Standards Board (FASB)** noted the following characteristics that it felt distinguished government and not-for-profit organizations from business organizations:

- a. Receipts of significant amounts of resources from resource providers who do not expect to receive either repayment or economic benefits proportionate to the resources provided.
- b. Operating purposes that are other than to provide goods or services at a profit or profit equivalent.
- c. Absence of defined ownership interests that can be sold, transferred, or redeemed or that convey entitlement to a share of a residual distribution of resources in the event of liquidation of the organization.<sup>3</sup>

The **Governmental Accounting Standards Board (GASB)** distinguishes government entities in the United States from both not-for-profit and business entities by stressing that governments exist in an environment in which the power ultimately rests in the hands of the people. Voters delegate that power to public officials through the election process. The power is divided among the executive, legislative, and judicial branches of the government, so that the actions, financial and otherwise, of government executives are constrained by legislative actions, and executive and legislative actions are subject to judicial review. Further constraints are imposed on state and local governments by the federal government. In the United States, higher levels of government encourage or dictate activities of lower-level governments. Higher levels of government partially or wholly finance some activities using an extensive system of intergovernmental grants and subsidies that require the lower levels to be accountable to the entity providing the resources, as well as to the citizenry.

Revenues raised by each level of government come, ultimately, from taxpayers. Taxpayers are involuntary contributors of revenue to governments, which effectively have monopoly power in most instances. As involuntary contributors of revenue, taxpayers often have little choice over the level of services they receive. The lack of a competitive market and the disconnect between the revenues provided by taxpayers and the cost for the level of service received means that unlike for-profit organizations, a “net income” figure cannot be used to assess government performance. Because there is no one “net income” figure that can be used to assess overall government efficiency and effectiveness, there is a great need for public accountability in financial reporting.<sup>4</sup>

<sup>3</sup> Financial Accounting Standards Board, *Statement of Financial Accounting Concepts No. 4*, “Objectives of Financial Reporting by Nonbusiness Organizations” (Norwalk, CT, 1980 as amended), par. 6. Other organizations use the term *nonprofit* as a synonym for *not-for-profit*. The term *not-for-profit* is predominantly used in this text.

<sup>4</sup> Governmental Accounting Standards Board (GASB), *Concepts Statement No. 1*, par. 18; GASB, *Codification of Governmental Accounting and Financial Reporting Standards as of June 30, 2019* (Norwalk, CT, 2019), app. B.



## SOURCES OF FINANCIAL REPORTING STANDARDS

### LO 1-2

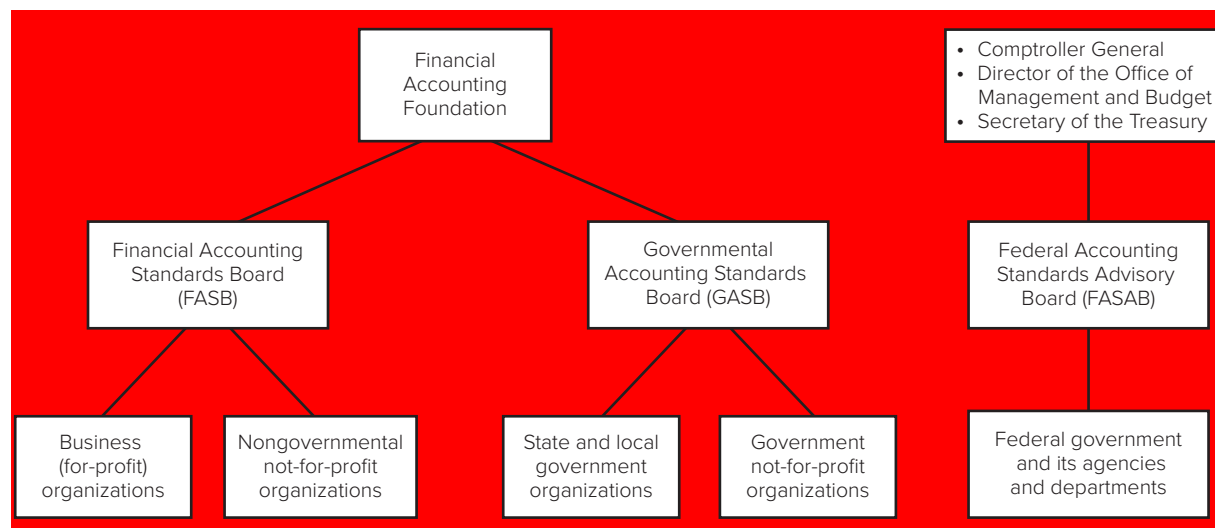
Identify the authoritative bodies responsible for setting financial reporting standards for (1) state and local governments, (2) the federal government, and (3) not-for-profit organizations.

As shown in Illustration 1–1, the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct formally designates the GASB, FASB, and FASAB as the authoritative bodies to establish **generally accepted accounting principles (GAAP)** for state and local governments, nongovernmental not-for-profit organizations, and the federal government, respectively. In practice, the “authority to establish accounting principles” means the “authority to establish accounting and financial reporting standards.”

Authority to establish accounting and reporting standards for not-for-profit organizations is split between the FASB and the GASB because a sizable number of not-for-profit organizations are governmental in nature, particularly public colleges and universities and government hospitals. Government not-for-profit organizations follow standards established by the GASB. The FASB is responsible for setting accounting and reporting standards for not-for-profit organizations that are independent of governments.

The GASB and the FASB are parallel bodies under the oversight of the Financial Accounting Foundation (FAF), which appoints the members of the two boards and supports the boards’ operations. The federal Sarbanes-Oxley Act mandated an assessed fee on corporate security offerings to support the FASB, while the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010) required the establishment of an accounting support fee to fund the GASB. In February 2012 the Financial Industry Regulatory Authority (FINRA) established such a fee.<sup>5</sup> The fee is collected from each firm that reports municipal securities trades to the Municipal Securities Rule-Making Board.

**ILLUSTRATION 1–1** Primary Sources of Accounting and Financial Reporting Standards for Businesses, Governments, and Not-for-Profit Organizations



<sup>5</sup> Financial Industry Regulatory Authority, *Regulatory Notice 13-17*, “GASB Accounting Support Fee,” April 2013.



Because of the method of support and the lack of ties to any single organization or government, the GASB and the FASB are referred to as “independent standards-setting boards in the private sector.” Before the creation of the GASB and the FASB, financial reporting standards were set by groups sponsored by professional organizations: The forerunners of the GASB (formed in 1984) were the National Council on Governmental Accounting (1973–84), the National Committee on Governmental Accounting (1948–73), and the National Committee on Municipal Accounting (1934–41). The forerunners of the FASB (formed in 1973) were the Accounting Principles Board (1959–73) and the Committee on Accounting Procedure (1938–59) of the American Institute of Certified Public Accountants.

Federal statutes assign responsibility for establishing and maintaining a sound financial structure for the federal government to three officials: the Comptroller General, the Director of the Office of Management and Budget, and the Secretary of the Treasury. In 1990, these three officials created the **Federal Accounting Standards Advisory Board (FASAB)** to recommend accounting principles and standards for the federal government and its agencies. It is understood that, to the maximum extent possible, federal accounting and financial reporting standards should be consistent with those established by the GASB and, where applicable, by the FASB.

## OBJECTIVES OF FINANCIAL REPORTING

### LO 1-3

Contrast and compare the objectives of financial reporting for (1) state and local governments, (2) the federal government, and (3) not-for-profit organizations.

As indicated earlier, due to the nature of government, there is a great need for public accountability, resulting in the GASB focusing its standards on *external* financial reporting. The need for public accountability led the GASB to state that “**Accountability** is the cornerstone of all financial reporting in government.”<sup>6</sup> Accountability requires governments to justify the raising and use of public resources, such as taxes. Government financial reports can provide citizens with the information needed to help with the public debate about the sources and uses of public resources.

Illustration 1–2 shows several ways that state and local government financial reporting is used in making economic, social, and political decisions and assessing accountability. Closely related to the concept of accountability is the concept the GASB refers to as interperiod equity. **Interperiod equity** can most simply be defined as ensuring that the government “lives within its means.” The GASB believes that interperiod equity is an important part of government accountability.<sup>7</sup> As such, financial reporting should provide information that assists users in evaluating whether the current period’s resources are sufficient to support the current period’s services. When the cost of the current period services is greater than the resources available, the excess costs become the burden of future taxpayers who have not received the benefit of the services.

Accountability is also the foundation for the financial reporting objectives the FASAB has established for the federal government. The FASAB’s *Statement of Accounting and Reporting Concepts Statement No. 1* identifies four objectives of federal financial reporting (see Illustration 1–2) focused on evaluating budgetary integrity, operating performance, stewardship, and adequacy of systems and controls. Budgetary integrity relates to being publicly accountable for complying with laws and regulations related to the raising and spending of taxes and other resources received by the federal government during a fiscal year. Financial reporting also

<sup>6</sup> GASB *Codification*, app. B; GASB, *Concepts Statement No. 1*, par. 56.

<sup>7</sup> *Ibid.*, par. 61.

**ILLUSTRATION 1–2** Comparison of Financial Reporting Objectives—State and Local Governments, Federal Government, and Not-for-Profit Organizations

State and Local Governments <sup>a</sup>	Federal Government <sup>b</sup>	Not-for-Profit Organizations <sup>c</sup>
<p>Financial reporting standards focus on needs of external users. Financial reporting is used in making economic, social, and political decisions and in assessing accountability primarily by</p> <ul style="list-style-type: none"> <li>• Comparing actual financial results with the legally adopted budget.</li> <li>• Assessing financial condition and results of operations.</li> <li>• Assisting in determining compliance with finance-related laws, rules, and regulations.</li> <li>• Assisting in evaluating efficiency and effectiveness.</li> </ul>	<p>Financial reporting standards focus on the needs of external and internal users. Financial reporting should help to achieve accountability and is intended to assist report users in evaluating</p> <ul style="list-style-type: none"> <li>• Budgetary integrity.</li> <li>• Operating performance.</li> <li>• Stewardship.</li> <li>• Adequacy of systems and controls.</li> </ul>	<p>Financial reporting standards focus on the needs of external users. Financial reporting should provide information useful in</p> <ul style="list-style-type: none"> <li>• Making resource allocation decisions.</li> <li>• Assessing services and ability to provide services.</li> <li>• Assessing management stewardship and performance.</li> <li>• Assessing economic resources, obligations, net resources, and changes in them.</li> </ul>

<sup>a</sup> Source: GASB, *Concepts Statement No. 1*, par. 32.

<sup>b</sup> Source: FASAB, *Statement of Federal Accounting Concepts No. 1*, par. 110.

<sup>c</sup> Source: FASB, *Concepts Statement No. 4*, pars. 35–43.

should help users assess the operating performance of the federal government. In addition to information on the cost of providing services, it is important to be able to evaluate the efficiency and effectiveness with which the government is managing its assets and liabilities. Stewardship relates to providing information on the financial position of the government. Financial reporting should assist in evaluating the government's operating performance and its investments for the period to determine whether the financial condition of the federal government has improved or deteriorated. Finally, federal financial reporting should help users in determining whether adequate internal and administrative control systems are in place.

The FASAB and its sponsors in the federal government are concerned with *both internal and external* financial reporting. Accordingly, the FASAB has identified four major groups of users of federal financial reports: citizens, Congress, executives, and program managers. Given the broad role the FASAB has been assigned, its standards focus on cost accounting and performance measures, as well as on financial accounting and reporting.

As Illustration 1–2 shows, the reporting objectives for not-for-profit organizations emphasize decision usefulness over financial accountability needs. The FASB *Statement of Financial Accounting Concepts No. 4* indicates that not-for-profit and business enterprises are similar in many ways; thus, the emphasis on decision usefulness in assisting *external* users with decisions regarding the allocation of scarce resources in a not-for-profit's objectives. A significant component of the decision on where to allocate scarce resources is the services the not-for-profit organization provides and its ability to continue to provide those services. To ensure ongoing service, resource providers and others are interested in management's stewardship, that is, its custody and safekeeping of the not-for-profit's assets and their efficient and effective use.

Note that the objectives of financial reporting for governments and not-for-profit organizations stress the need for the public to understand and evaluate the financial activities and management of these organizations. Readers will recognize the impact on their lives, and on their bank accounts, of the activities of the layers of government

they are obligated to support and of the not-for-profit organizations they voluntarily support. Because each of us is significantly affected by government and not-for-profit organizations, it is important that we be able to read intelligently the financial reports of these organizations.

## OVERVIEW OF FINANCIAL REPORTING FOR STATE AND LOCAL GOVERNMENTS, THE FEDERAL GOVERNMENT, AND NOT-FOR-PROFIT ORGANIZATIONS

### LO 1-4

Explain the minimum requirements for general purpose external financial reporting for state and local governments and how they relate to comprehensive annual financial reports.

### Financial Reporting of State and Local Governments

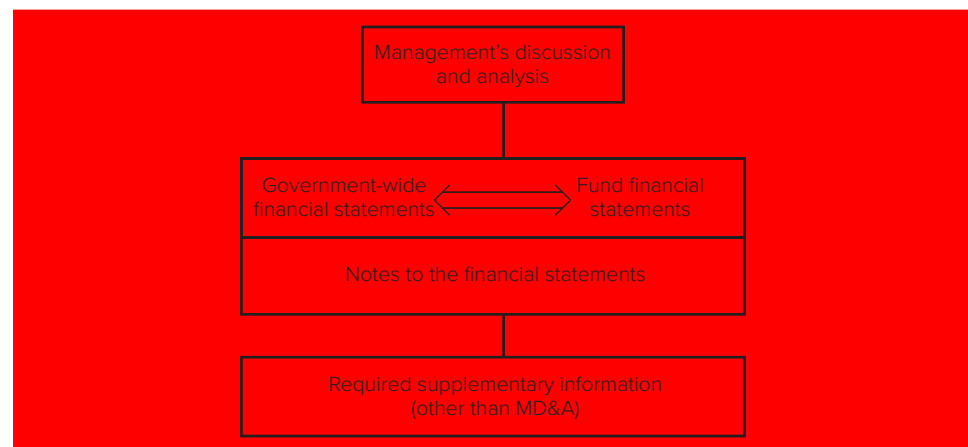
As shown in Illustration 1–2, the GASB, as well as the FASB, is concerned with establishing standards for financial reporting to external users—those who lack the authority to prescribe the information they want and who must rely on the information management communicates to them. The Board does not intend to set standards for reporting to managers and administrators or others deemed to have the ability to enforce their demands for information.

### General Purpose External Financial Reporting

Illustration 1–3 displays the minimum requirements for general purpose external financial reporting under the government financial reporting model specified by the GASB. Central to the model is the **management's discussion and analysis (MD&A)**, designed to communicate in narrative, easily readable form the purpose of the basic financial statements and the government's current financial position and results of financial activities compared with those of the prior year. The MD&A is considered so important the GASB identifies it as **required supplementary information (RSI)**.

As shown in Illustration 1–3, the GASB prescribes two categories of **basic financial statements**: government-wide and fund. **Government-wide financial statements** are intended to provide an aggregated overview of a government's net position and changes in net position. You will notice that the GASB uses the term *net position*

### ILLUSTRATION 1-3 Minimum Requirements for General Purpose External Financial Reporting



Source: GASB Codification, Sec. 2200.103.

## 8 Accounting for Governmental & Nonprofit Entities

rather than the FASB term *net assets*; however, the terms are substantially the same. The government-wide financial statements report on the government as a whole and assist in assessing **operational accountability**—whether the government has used its resources efficiently and effectively in meeting operating objectives. The GASB concluded that reporting on operational accountability is best achieved by using essentially the same basis of accounting and measurement focus used by business organizations: the accrual basis and flow of economic resources measurement focus.

**Fund financial statements**, the other category of basic financial statements, provide more detailed financial information about the government. Certain funds, referred to as *governmental funds*, focus on the short-term flow of current financial resources rather than on the flow of economic resources.<sup>8</sup> The focus on current financial resources makes it easier for users assessing **fiscal accountability**, which relates to ensuring the government is complying with the public's decisions concerning the raising and spending of resources generally within a budgetary period of one year. Because of the short-term focus, governmental funds use a modified accrual basis of accounting rather than the accrual basis. Under **modified accrual**, revenues are recognized in the period they are measurable and available for spending, and expenditures (not expenses) are recognized when they create an obligation to be paid from current financial resources. The characteristics and roles of the government-wide and fund financial statements are summarized in Illustration 1–4.

Other funds, referred to as *proprietary* and *fiduciary funds*, account for the business-type and certain fiduciary (trust and custodial) activities of the government. These funds follow accounting and reporting principles similar to those of business organizations.

As shown in Illustration 1–3, the notes to the financial statements are considered integral to the financial statements. In addition, governments are required to disclose certain RSI other than MD&A. These additional information disclosures are discussed in several of the following chapters.

### **Comprehensive Annual Financial Report**

Serious users of government financial information need more detail than is found in the general purpose external financial reports. For state and local governments,

#### **ILLUSTRATION 1–4 Dual Roles of Government Financial Statements in Assessing Accountability**

	<b>Operational Accountability</b>	<b>Fiscal Accountability</b>
Statements	Government-wide financial statements (governmental and business-type activities) and those of proprietary funds and fiduciary funds	Governmental fund financial statements
Measurement focus	Flow of economic resources	Flow of current financial resources
Basis of accounting	Accrual basis (revenues and expenses are recognized when exchange of economic resources occurs or per GASB recognition rules for nonexchange transactions, such as taxes, contributions, and grants)	Modified accrual basis (revenues are recognized when resources are measurable and available for current spending; <i>expenditures</i> are recognized when an obligation to spend current financial resources is incurred)

<sup>8</sup> The definition of *fund* is given in Chapter 2. For now, you can view a fund as a separate set of accounts used to account for resources segregated for particular purposes.

much of that detail is found in the government's **comprehensive annual financial report (CAFR)**. Although governments are not required to prepare a CAFR, most do so as a matter of public record and to provide additional financial details beyond the minimum requirements shown in Illustration 1–3. As such, the GASB provides standards for the content of a CAFR in its annually updated publication *Codification of Governmental Accounting and Financial Reporting Standards*. A CAFR prepared in conformity with these standards should contain the following sections.<sup>9</sup>

**Introductory Section**<sup>10</sup> The introductory section typically includes items such as a title page and contents page, a letter of transmittal, a description of the government, and other items deemed appropriate by management. The letter of transmittal may be literally that—a letter from the chief financial officer addressed to the chief executive and governing body of the government—or it may be a narrative over the signature of the chief executive. In either event, the letter or narrative material should cite legal and policy requirements for the report.

**Financial Section** The financial section of a comprehensive annual financial report should include

1. An auditor's report,
2. Management's discussion and analysis (MD&A),
3. Basic financial statements and related notes,
4. Required supplementary information other than MD&A, and
5. Other supplementary information, such as combining statements and individual fund statements and schedules.

Items 2, 3, and 4 represent the minimum requirements for general purpose external financial reporting, as depicted in Illustration 1–3. As you will recognize, a CAFR provides additional supplementary financial information beyond the minimum amount required by generally accepted accounting principles.

Laws regarding who conducts the audits of governments, and the size of governments required to have an audit, vary from state to state. However, if the government's financial statements have been audited, the auditor's opinion should accompany the financial statements reproduced in the report.

The financial section should contain sufficient information to disclose fully and present fairly the financial position and results of financial operations during the fiscal year. Laws of higher jurisdictions, actions of the legislative branch of the government itself, and agreements with creditors and others impose constraints over governments' financial activities and create unique financial accountability requirements.

**Statistical Section** In addition to the introductory and financial sections of the CAFR, which were just described, a CAFR should contain a statistical section. The statistical section typically presents tables and charts showing demographic and economic data,

<sup>9</sup> GASB *Codification*, sec. 2200.105.

<sup>10</sup> For a view of the introductory section, as well as the other sections of the CARR, you may wish to look at the City and County of Denver, Colorado's CAFR at [https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Financial\\_Reports/CAFR/CAFR\\_2019.pdf](https://www.denvergov.org/content/dam/denvergov/Portals/344/documents/Financial_Reports/CAFR/CAFR_2019.pdf). Portions of Denver's CAFR for 2019 are included for illustrative purposes in various places in the text.

financial trends, fiscal capacity, and operating information of the government in the detail needed by readers who are more than casually interested in the activities of the government. The GASB *Codification* requires a specific set of statistical tables for inclusion in a CAFR. The statistical section is discussed at greater length in Chapter 9 of this text.

### Financial Reporting of the Federal Government

#### LO 1-5

Identify and describe the required financial statements for the federal government.

The FASAB is concerned with establishing standards that help meet the financial information needs of both internal and external users. Standards should lead to financial reports that are useful in assessing government accountability, efficiency, and effectiveness and the consequences of allocating and using federal resources.<sup>11</sup>

#### *U.S. Government-wide Financial Reporting*

For more than a decade, the Department of the Treasury has prepared a prototype financial report for the U.S. government as a whole.<sup>12</sup> The financial report includes a “plain language” *Citizen’s Guide*, a management’s discussion and analysis (MD&A), several financial statements,<sup>13</sup> and supplemental information that reports on both the government’s budget and proprietary financial activities, as well as reconciliation of the two. Of particular interest is a statement of social insurance (e.g., Social Security and Medicare, among other commitments) that reflects an excess of the present value of future actuarial expenditures over revenues and assets at the end of fiscal year 2019 of more than \$13.8 trillion.

Although the federal government’s consolidated financial statements are audited, readers may be surprised to learn that despite the enormous dollar amounts involved, the U.S. Comptroller General has never been able to issue an unmodified audit opinion on the federal government’s consolidated financial statements.

#### *Federal Department and Agency Financial Reporting*

The federal Office of Management and Budget’s (OMB) *Circular A-136* requires major federal departments and agencies to prepare a **performance and accountability report (PAR)** that includes an annual performance report (APR), annual financial statements, and a variety of management reports on internal control and other accountability issues. A PAR is intended to increase accountability by providing both financial and performance information that helps users in assessing how well an agency of the federal government is carrying out its mission. There are four sections in a PAR:

1. An MD&A, which serves as a brief overview of the entire PAR and clearly describes the department or agency’s mission and organizational structure; its performance goals, objectives, and results; analysis of its financial statements; and analysis of information about internal controls and legal compliance.

<sup>11</sup> Federal Accounting Standards Advisory Board website: <https://fasab.gov/about-fasab/mission-objectives/>, accessed February 1, 2020.

<sup>12</sup> The FY 2019 Financial Report of the U.S. government can be viewed and downloaded at [www.fms.treas.gov/fr/index.html](http://www.fms.treas.gov/fr/index.html).

<sup>13</sup> Financial statements included in the U.S. government’s Consolidated Financial Report are comparative statements of net cost, statements of operations and changes in net position, reconciliation of net operating cost and unified budget deficit, statements of changes in cash balance from unified budget and other activities, balance sheets, and statements of social insurance. See Chapter 17 for more information about these statements.



2. Performance information. The APR provides information about the agency's performance and progress in achieving its performance goals.
3. Basic financial statements. These include a balance sheet, statement of net cost (essentially an operating statement format that is presented with expenses reported before revenues; that is, program costs minus earned revenues results in net cost), statement of changes in net position (similar to changes in owners' equity in business accounting), statement of budgetary resources, statement of custodial activity, and statement of social insurance.
4. Other accompanying information, such as perspectives on the tax burden, size of the tax gap, challenges facing management, and revenue forgone.

Federal government financial reporting places a strong emphasis on management's performance, in addition to the reporting of financial information. Chapter 17 explains federal department and agency financial reporting requirements in much greater detail and provides examples of each financial statement.

### Financial Reporting of Not-for-Profit Organizations (NFPs)

#### LO 1-6

Identify and describe the required financial statements for not-for-profit organizations.

Most NFPs are nongovernmental in nature and, therefore, follow FASB accounting and financial reporting standards. The primary purpose of NFP financial statements is to provide decision-useful financial information to external users, principally resource providers such as donors, members, and creditors, among others. Resource providers have in common the need to assess (1) the services provided by an NFP and the ability of the NFP to continue to provide those services and (2) management's performance and stewardship of resources.<sup>14</sup> To meet these reporting needs, FASB standards require NFPs to prepare a set of organization-wide financial statements that include:

1. A statement of financial position (balance sheet),
2. A statement of activities (income statement), and
3. A statement of cash flows.<sup>15</sup>

In addition, NFPs are required to provide information showing the relationship between program and support functional expenses and natural expense classifications such as personnel, travel, and supplies. This information can be provided in one of three ways:

1. On the statement of activities,
2. In a schedule in the notes to the financial statements, or
3. As a separate financial statement.<sup>16</sup>

Chapter 14 provides examples of all these statements.

Many NFPs depend heavily on donor contributions to finance their operations. Donors often impose restrictions on the use of contributions, such as specifying that their contribution be used for a particular purpose or in a particular time period. **Donor-imposed restrictions** may be temporary or, in the case of certain endowments, permanent. Permanent endowments require the NFP to maintain the principal amount

<sup>14</sup> Financial Accounting Standards Board, *Accounting Standards Codification* (Norwalk, CT), sec. 958-205-05-3.

<sup>15</sup> Ibid. sec. 958-205-05-5.

<sup>16</sup> Ibid. sec. 958-205-45-6.

of the contribution in perpetuity but permit the use of earnings on invested principal, either without restriction or for a particular restricted purpose.

FASB standards recognize the essential need for management to demonstrate accountability for donor-restricted resources. Specifically, the standards require that an NFP's statement of financial position report net assets (the excess of total assets over total liabilities) in two categories: net assets with donor restrictions and net assets without donor restrictions.<sup>17</sup> The statement of activities reports increases and decreases in each of the two categories of net assets.

In addition, it is important that an NFP's statement of activities report expenses incurred for direct support of programs separately from support activities, which are titled management and general expenses and fund-raising costs. Reporting expenses in this way is an important aspect of accountability because it allows donors, oversight bodies, and others to calculate what percentage of total expenses is being incurred for program purposes, rather than for overhead and fund-raising.

Similar to for-profit entities, the FASB allows NFPs to prepare the statement of cash flows using the direct or indirect method. However, the FASB does not require NFP organizations using the indirect method to prepare the reconciliation section of the statement.

NFP organizations' need for audited financial statements varies as a result of state regulations, creditor requirements, and grantor requirements. If an NFP organization expends federal grant funds that exceed a certain threshold, it is subject to the same federal audit requirements as would be required for state and local governments.

As with state and local government and federal government financial reporting, a complete discussion of NFP financial reporting is deferred to later chapters of the text. Chapters 13 through 16 will provide a more comprehensive understanding of NFP accounting and financial reporting, for both nongovernmental and government NFPs.

## EXPANDING THE SCOPE OF ACCOUNTABILITY REPORTING

The increased emphasis on government transparency and increased use of technology has allowed many governments to increase the availability of unaudited government data to those outside government. Open Government<sup>18</sup> is a federal open data website that provides access to not only federal data but also state and local government data websites. State and local governments are increasingly using commercial products that allow external users access to a variety of government data sets including government "checkbooks" that provide information on individual government transactions. Recently, there has been a move to have governments provide financial reports in an open source data format such as XBRL, which is currently used by publicly traded firms regulated by the Securities and Exchange Commission.

Some governments publish highly condensed popular reports that are frequently available on their websites. These reports usually contain selected data from the audited financial statements, statistical data, graphic displays, and narrative explanations, but the reports themselves are not audited. Additional information on popular reporting is provided in Chapter 9.

<sup>17</sup> Ibid. sec. 958-205-05-6A.

<sup>18</sup> Open Government can be accessed at [www.data.gov/open-gov/](http://www.data.gov/open-gov/).



In addition, many state and local governments identify and report nonfinancial performance measures. The GASB has long encouraged state and local governments to experiment with reporting **service efforts and accomplishments (SEA)** measures to provide more complete information about a government's performance than can be provided by basic financial statements, budgetary comparison schedules, and other required or supplementary schedules. Indicators of service efforts include inputs of nonmonetary resources as well as inputs of dollars. Indicators of service accomplishments include both outputs and outcomes; outputs are quantitative measures of work done, such as the number of juvenile cases handled, and outcomes are the impacts of outputs on program objectives, such as a reduction in the high school dropout rate or incidence of juvenile crime. Chapter 12 provides additional discussion of SEA measures.

The FASB also recognizes that SEA measures can provide valuable information to NFP resource providers because performance cannot generally be measured by the organization's profits and the resource providers are frequently not the beneficiaries of the NFP's goods or services.<sup>19</sup> However, due to the fact that no standardized method of measuring and reporting service accomplishments exists, the FASB does not include it as part of the financial reporting requirements, but similar to the GASB, it encourages the provision of such information in addition to the information provided by financial reports.

## OVERVIEW OF CHAPTERS 2 THROUGH 17

The remainder of the text is divided into three sections. A brief overview of the content of each section is provided in the following paragraphs.

### **GASB Principles, Standards, and Financial Reporting**

Part I of the text (Chapters 2–9) focuses on state and local governments. The principles that underlie GASB accounting and reporting standards are presented in Chapter 2. Chapters 3 through 8 provide detailed illustrations of the effect of financial transactions on the funds and government-wide statements. Financial reporting for state and local governments is described in detail in Chapter 9.

### **Accountability for Public Funds**

Part II of the text includes three chapters that describe ways that public financial managers provide accountability over funds entrusted to them. Chapter 10 provides information on how to analyze the financial performance of state and local governments based on financial and other information. Auditing techniques designed to assure the public that funds are properly recognized and spent efficiently and effectively are described in Chapter 11, with special attention devoted to areas of auditing that are unique to federal funds, such as single audits. Chapter 12 covers tools important to managers in demonstrating accountability for funds, such as budgeting, costing, and performance measurement.

### **Not-for-Profit Organizations and the Federal Government**

Part III is a set of four chapters covering the unique accounting and financial reporting issues facing entities in the not-for-profit sector and a final chapter on accounting

<sup>19</sup>FASB, *Concepts Statement No. 4*, par. 51.

## 14 Accounting for Governmental & Nonprofit Entities

and financial reporting for the federal government. The governance and regulatory issues that a not-for-profit organization faces from the time of its incorporation through merger or dissolution, if any, are presented in Chapter 13. Chapter 14 provides detailed illustrations of the effect of financial transactions on the financial statements of not-for-profit organizations, much like Chapters 3 through 8 do for state and local governments. Chapters 15 and 16 present industry-specific accounting and financial reporting requirements for colleges and universities and health care organizations, respectively. Chapter 17 focuses on the federal government, the largest provider of public funds, and introduces federal offices that interact with state and local governments and not-for-profit organizations in a variety of ways; for example, the Government Accountability Office (GAO) and the Office of Management and Budget (OMB).

## A CAVEAT

The first edition of this text was written by the late Professor R. M. Mikesell nearly 70 years ago in 1951. Some words of his bear thoughtful rereading from time to time by teachers and students in all fields, not just those concerned with accounting and financial reporting for government and not-for-profit organizations:

Even when developed to the ultimate stage of perfection, governmental accounting cannot become a guaranty of good government. At best, it can never be more than a valuable tool for promotion of sound financial management. It does not offer a panacea for all the ills that beset representative government; nor will it fully overcome the influence of disinterested, uninformed citizens. It cannot be substituted for honesty and moral integrity on the part of public officials; it can help in resisting but cannot eliminate the demands of selfish interests, whether in the form of individual citizens, corporations, or the pressure groups which always abound to influence government at all levels.<sup>20</sup>

<sup>20</sup> R. M. Mikesell, *Governmental Accounting*, rev. ed. (Homewood, IL: Richard D. Irwin, 1956), p. 10.

Accountability, 5	Fund financial statements, 8	Modified accrual, 8
Basic financial statements, 7	General purpose governments, 2	Operational accountability, 8
Comprehensive annual financial report (CAFR), 9	Generally accepted accounting principles (GAAP), 4	Performance and accountability report (PAR), 10
Donor-imposed restrictions, 11	Governmental Accounting Standards Board (GASB), 3	Required supplementary information (RSI), 7
Federal Accounting Standards Advisory Board (FASAB), 5	Government-wide financial statements, 7	Service efforts and accomplishments (SEA), 13
Financial Accounting Standards Board (FASB), 3	Interperiod equity, 5	Special purpose governments, 2
Fiscal accountability, 8	Management's discussion and analysis (MD&A), 7	

- 1-1. Identify some differences between business organizations and government/not-for-profit organizations.
- 1-2. Using GP for general purpose government or SP for special purpose government, identify the following governments by type.
  - a. Orleans Parrish.
  - b. Lynnford Regional Library District.
  - c. Hillsborough County Independent School District.
  - d. Durango, Colorado.
  - e. Hohenstein Township.
  - f. Nelson Fire District.
- 1-3. Which standard-setting bodies have responsibility for establishing accounting and reporting standards for (1) state and local governments, (2) business organizations, (3) not-for-profit organizations, and (4) the federal government and its agencies and departments?
- 1-4. What are the required financial statements for nongovernmental not-for-profit organizations?
- 1-5. What is *interperiod equity*, and how does it relate to fiscal accountability?
- 1-6. Explain the purpose of *operational accountability* and the purpose of *fiscal accountability*. Which category of financial statements is most useful in reporting on each of these accountability concepts?
- 1-7. What is the primary financial reporting objective for not-for-profit organizations? How does this differ from the primary financial reporting objective for a government?
- 1-8. Why are federal government financial reports prepared?
- 1-9. Identify and describe the four sections of a federal department or agency's *performance and accountability report*.
- 1-10. A not-for-profit organization is required to report expenses incurred for programs separately from management and general expenses and fund-raising costs. Explain who would use this information and why this separation matters.
- 1-11. **Research Case—Accountability Reporting. (LO1-4)** Many governments are making an increasing amount of data accessible to citizens and other interested parties. One common source for accessing the data of various governments is through the federal government's Open Government portal at [www.data.gov](http://www.data.gov).

**Required**

Access the Open Government website using the URL provided to answer the following questions:

- a. Why is data.gov important?
- b. What governments provide data to data.gov?
- c. Go to one of the cities providing data and list the types of data that are available for viewing from that city.
- 1-12. **Research Case—GASB. (LO1-2)** Access the Governmental Accounting Standards Board website at [www.GASB.org](http://www.GASB.org). Find the GASB White Paper on "Why Governmental Accounting and Financial Reporting Is—and Should

Be—Different.” There are numerous differences between governments and for-profits in the accounting and reporting of financial transactions. Two accounting and reporting differences between governments and for-profits relate to major revenue sources and postemployment benefits. Using the information in the White Paper and your knowledge from your financial accounting courses (refer to a financial accounting textbook or the FASB website [[www.FASB.org](http://www.FASB.org)] if you need a refresher), discuss why there are accounting and reporting differences related to the organizations’ major revenue sources and postemployment benefits.

- 1–13. Research Case—FASB. (LO1-6)** Access the Financial Accounting Standards Board website at [www.FASB.org](http://www.FASB.org). Find the Accounting Standards Updates for 2019. In 2019 two updates were issued related to financial reporting for not-for-profit entities. After reading the 2019 updates, write a brief report that identifies how the standard changed for reporting intangible assets and collections.
- 1–14. Research Case—FASB. (LO1-3)** *Concepts Statement 4* (accessible at [www.FASB.org](http://www.FASB.org)) discusses the concepts of stewardship and performance. Given that providing decision-useful information is the primary purpose of not-for-profit financial statements, what is the role of financial reporting relative to stewardship and performance? Write a brief report that provides your analysis.
- 1–15. Research Case—FASAB. (LO1-2)** Examine the Federal Accounting Standards Advisory Board’s website at [www.FASAB.gov](http://www.FASAB.gov); then prepare a brief report about its mission and structure and compile a list of organizations represented on its Accounting and Auditing Policy Committee. Can you obtain a copy of the full text of FASAB statements from this website? If not, how would you obtain a copy of a statement pertinent to federal agencies? What is the cost to purchase a statement?
- 1–16. Research Case—Federal Financial Reporting Objectives. (LO1-3)** *Statement of Financial Accounting Concepts 1*, “Objectives of Federal Financial Reporting,” at [http://files.fasab.gov/pdf/files/handbook\\_sffac\\_1.pdf](http://files.fasab.gov/pdf/files/handbook_sffac_1.pdf), identifies accountability and decision usefulness as the fundamental values of federal government financial accounting and reporting. The statement identifies four groups of users to whom the government owes accountability and the possible needs of each user group.

#### **Required**

Briefly describe the user groups, their needs for information, and how these tie into the four objectives of federal financial reporting identified in the statement.

All applicable Exercises and Problems are available with Connect.



- 1–17. Examine the CAFR. (LO1-4)** Download a copy of the most recent comprehensive annual financial report (CAFR) for a city of your choice. Many cities with 25,000 or more population provide Internet access to their CAFRs.\*

\* You can usually access a city’s CAFR by doing a search on “City of (name)” and looking for a link to the city’s departments. At that link, select Finance Department or a department with a similar function, such as Accounting and Budgeting, and look for “Financial Reports” or similar link.

Familiarize yourself with the city's CAFR and reread the section in this chapter titled "Financial Reporting of State and Local Governments." Be prepared to discuss in class the items suggested below.

- a. **Introductory Section.** What has the city included in the introductory section of its CAFR? Does it include the items identified in the section of the text titled "Comprehensive Annual Financial Report"?
- b. **Financial Section.**
  - (1) *Audit Report.* Are the financial statements in the report audited by an independent CPA, state auditors, or auditors employed by the government being audited? Does the audit indicate that the financial statements were prepared in accordance with GAAP? Has the city received an unmodified audit report?
  - (2) *Basic Financial Statements.* Does the CAFR contain both government-wide financial statements and fund statements? How many financial statements have been included as part of the basic financial statements section of the CAFR?
  - (3) *Notes to the Financial Statements.* How many notes follow the required basic financial statements? Is there a phrase at the bottom of the basic financial statements indicating that the notes are an integral part of the financial statements?
  - (4) *Other Supplementary Information.* Following the notes to the financial statements, does the CAFR provide other supplementary information, such as combining and individual fund statements?
  - (5) *Management's Discussion and Analysis (MD&A).* Does the CAFR contain an MD&A? If so, where is it located and what type of information does it contain?
- c. **Statistical Tables.** What information has been included in this section of the CAFR?

- 1–18. Compare Financial Statements. (LO1-4, LO1-6)** For this exercise refer to the Denver government-wide statement of net position (Illustration A2–1); the Denver government-wide statement of activities (Illustration A2–2); the Promote Health Association, Inc.'s balance sheet (Illustration 14–1), and the Promote Health Association, Inc.'s statement of activities (Illustration 14–2).

**Required**

- a. Compare Denver's statement of net position to the Promote Health Association, Inc.'s balance sheet. What are some similarities and differences in the statement formats?
- b. Compare Denver's statement of activities to the Promote Health Association, Inc. statement of activities. What are some similarities and differences in the statement formats?

- 1–19. Multiple Choice. (LO1-1 through LO1-6)** Choose the best answer.

1. Which of the following is a special purpose government?
  - a. The State of Arkansas.
  - b. Greene Township.
  - c. City of Seattle.
  - d. Minneapolis Public Schools.

2. Which of the following statements is *true* for both government organizations and for-profit organizations?
  - a. Revenues may be earned through exchange transactions.
  - b. There is an absence of owners.
  - c. There is a lack of profit motive.
  - d. Resources are provided by individuals and entities that may not directly benefit from the use of the resources.
3. Which of the following statements regarding primary sources of accounting and financial reporting standards is *false*?
  - a. The GASB sets standards for all state and local governments.
  - b. The FASB sets standards for all business and not-for-profit entities.
  - c. The FASB and GASB are administered by the Financial Accounting Foundation.
  - d. The FASAB sets standards for the federal government and its agencies and departments.
4. A tax watchdog group is interested in ensuring that the city does not spend more than the amount of resources it receives in the current fiscal year. The watchdog group is primarily interested in
  - a. Fiscal accountability.
  - b. Social accountability.
  - c. Political accountability.
  - d. Operational accountability.
5. The concept of *interperiod equity* refers to whether
  - a. Revenues equaled or exceeded expenses for the year.
  - b. Total assets (current and noncurrent) were sufficient to cover total liabilities (current and noncurrent).
  - c. Current-year revenues were sufficient to pay for current-year services.
  - d. Future taxpayers can expect to receive the same or a higher level of services as current taxpayers.
6. What are the components that are included in the minimum requirements for general purpose external financial reporting?
  - a. Introductory section, financial section, and statistical section.
  - b. MD&A, government-wide financial statements, fund financial statements, notes to the financial statements, and RSI.
  - c. Letter from the chief financial officer, government financial statements, notes to the financial statements, and RSI.
  - d. MD&A, government-wide financial statements, notes to the financial statements, and RSI.
7. Which of the following financial statements is *not* a basic financial statement under FASAB standards?
  - a. Balance sheet.
  - b. Statement of changes in net position.
  - c. Statement of cash flows.
  - d. Statement of social insurance.
8. Which of the following is *not* a required section of a federal agency or department's performance and accountability report (PAR)?
  - a. A performance section, which includes an annual performance report (APR).
  - b. An MD&A.

## Chapter 1 Introduction to Accounting and Financial Reporting for Government and Not-for-Profit Entities

- c. A basic financial statements section.
  - d. A statement of nonparticipation in political matters.
9. The basic financial statements of a not-for-profit include all of the following *except*
- a. Statement of financial position.
  - b. Statement of activities.
  - c. Statement of changes in functional expenses.
  - d. Statement of cash flows.
10. The *primary* reason that not-for-profit (NFP) organizations should report expenses incurred for program purposes separately from those for supporting services such as management and general and fund-raising is that
- a. GASB standards require it.
  - b. Program managers need information about the cost of activities for which they are responsible.
  - c. Top managers need to know how much they are spending for nonprogrammatic management and general support.
  - d. Donors, potential donors, oversight bodies, and others need to know what percentage of total expenses are being incurred for carrying out the NFP's programs.

**1–20. Matching. (LO1-1, LO1-2, LO1-4, LO1-5)** For each characteristic, concept, or financial reporting requirement listed, indicate a Y for yes in the type of organization column if the item applies to that type of organization or N for no if it does not apply.

Characteristic, Concept, or Financial Reporting Requirement	State and Local Governments	Federal Government	Nongovernmental Not-for-Profit Organizations
Accountability is the foundation of financial reporting			
Management's discussion and analysis (MD&A)			
Performance & accountability report			
Stewardship is identified as a financial statement purpose			
A concern with budgetary compliance			
Absence of defined ownership interests			
Oversight by the Financial Accounting Foundation (FAF)			
Required fund financial statements are presented as part of the financial report			
Considered private sector standard-setting boards			
Standards focus on just external users of financial information			



- 1–21. Matching. (LO1-2)** For each of the following entities, identify if the entity would be governed by GASB standards by placing a “G,” FASB standards by placing an “F,” or FASAB standards by placing an “FB.” (Hint: Search the website of the entity listed if you are unsure.)

*Entity*

- \_\_\_\_\_ 1. Your university
- \_\_\_\_\_ 2. Homeland Security
- \_\_\_\_\_ 3. American Institute of Certified Public Accountants
- \_\_\_\_\_ 4. The Department of the Interior
- \_\_\_\_\_ 5. American Diabetes Association
- \_\_\_\_\_ 6. New York City
- \_\_\_\_\_ 7. Mayo Clinic
- \_\_\_\_\_ 8. The county, parish, or borough in which you live
- \_\_\_\_\_ 9. Bay Area Rapid Transit (BART—operated in the San Francisco Bay area)
- \_\_\_\_\_ 10. The Metropolitan Museum of Art, New York City

# Chapter Two



Arina Habich/Alamy  
Stock Photo

## Principles of Accounting and Financial Reporting for State and Local Governments

### Learning Objectives

**After studying this chapter, you should be able to:**

- 2-1 Describe the concepts related to the financial reporting requirements of the GASB reporting model.
- 2-2 Explain the purpose of the three major activity categories of a state or local government: (1) governmental activities, (2) business-type activities, and (3) fiduciary activities.
- 2-3 Explain the Governmental Accounting Standards Board's (GASB) integrated accounting and financial reporting model, including (1) government-wide financial statements and (2) fund financial statements.
- 2-4 Discuss fund reporting including: (1) definition of fund and principles of fund accounting, and (2) types of funds in each fund category and characteristics of each fund type.

Chapter 1 presented a brief overview of the minimum requirements for general purpose external financial reporting under the GASB financial reporting model. This chapter expands on the previous discussion and focuses primarily on principles of accounting and financial reporting within the GASB's integrated reporting model framework.

When the GASB was first formed in 1984, it adopted the accounting and financial reporting principles established by its predecessor standard-setting body, the National Council on Governmental Accounting (NCGA). Since that time, the GASB has modified several of the principles and developed a conceptual framework that forms the base for development of current standards. Because the conceptual framework forms the base on which accounting and financial reporting standards are established, it is important to have a basic understanding of the GASB conceptual framework.

## CONCEPTUAL FRAMEWORK—PROVIDING USEFUL FINANCIAL REPORTS

### LO 2-1

Describe the concepts related to the financial reporting requirements of the GASB reporting model.

GASB concept statements primarily serve the needs of standard setters, providing them with guidance in writing standards that form the basis for the type and display of information found in the financial reports.

There are currently six concept statements comprising the GASB conceptual framework. Those statements are

1. *Concepts Statement No. 1, Objectives of Financial Reporting.*
2. *Concepts Statement No. 2, Service Efforts and Accomplishments Reporting, as amended.*
3. *Concepts Statement No. 3, Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements.*
4. *Concepts Statement No. 4, Elements of Financial Statements.*
5. *Concepts Statement No. 5, an amendment to Concepts Statement No. 2.*
6. *Concepts Statement No. 6, Measurement of Elements of Financial Statements.*

Although the concept of reporting on a government's performance relative to its service efforts and its accomplishments (GASB *Concepts Statement No. 2*, as amended by *Concepts Statement No. 5*) is an important activity of governments, such reporting activities are not a part of the financial reports that are primarily discussed in the textbook. As such, the following discussion of the conceptual framework focuses on the other four concept statements. Service efforts and accomplishments are discussed more completely in Chapter 12.

### Concepts Statement No. 1

GASB *Concepts Statement No. 1*<sup>1</sup> indicates that government financial reports should provide information that can be used to assess a government's accountability and assist users in making economic, social, and political decisions. To help meet these goals, the GASB has identified three specific objectives of financial reporting. Financial reports should assist users in assessing

1. The government's duty to be publicly accountable for the acquisition and use of government resources to ensure efficient and effective provision of services in accordance with legally adopted budgets and other legal and contractual obligations.
2. The operating results for the current period and determining the state of the government's financial position.
3. The government's level of services and its ability to meet its obligations as they come due.<sup>2</sup>

Chapter 1 provided the definition of accountability and its importance in government reporting. The primary users of government financial reports are those external to government: principally citizens, legislative and oversight bodies, and creditors.

For the financial reports to be useful in meeting identified objectives, the GASB indicates that the information provided in the reports should have certain characteristics.

<sup>1</sup> Governmental Accounting Standards Board, *Codification of Governmental Accounting and Financial Reporting Standards as of June 30, 2019* (Norwalk, CT, 2019), app. B.

<sup>2</sup> GASB *Codification*, app. B; *Concept Statement No. 1*, pars. 77–79.

The characteristics identified are understandable, reliable, relevant, timely, consistent, and comparable.

### Concepts Statement No. 3

An important part of providing useful information is communicating report information in a manner that is helpful to the user. GASB *Concepts Statement No. 3* provides guidance regarding where and how items of information should appear in financial reports to be the most useful. The areas identified for communicating items of information are

1. Recognition in the financial statements,
2. Disclosure in the notes to the financial statements,
3. Presentation as required supplementary information, and
4. Presentation as supplementary information.<sup>3</sup>

The GASB indicates that an item of information that meets the definition of an element and is measurable with sufficient reliability should be recognized in the financial statements. A note should be used if it can help support an item recognized in a financial statement or provide information that is essential to the user's understanding of the item. An example of the relationship between recognized items and notes can be conveyed with the Investments account. Without a note disclosure relating information on fair values and risk exposure, the financial statement user is left without information that is relevant in assessing the quality and management of the government's investments.

Required supplementary information (RSI) and supplementary information are used to communicate information that is essential and useful, respectively. Without RSI, the financial statements and related notes cannot be placed in the correct context. For example, many users of financial reports highly value the management discussion and analysis (MD&A) when trying to put into context numbers presented in the financial reports. Other examples of RSI include the budget to actual schedules (discussed in Chapter 3) and several pension disclosures (Chapter 8). Other supplementary information is useful but not essential in understanding the financial statements and related notes. Much of the supplementary information is found in the statistical section of the comprehensive annual financial report (CAFR).

### Concepts Statement No. 4

As will be shown, preparing government-wide and fund financial statements presents unique challenges to financial reporting for governments. One of those challenges is to define the elements of the financial statements. In *Concepts Statement No. 4*, the GASB defines the elements that will appear in the two kinds of financial statements. You will recognize some of the elements used in government financial statements as being similar to those used by business organizations; however, other elements will be unique to governments. The seven elements as defined by *Concepts Statement No. 4* are as follows:

1. Assets, which are resources with present service capacity that the government presently controls.
2. Deferred outflows of resources, which are the consumption of net assets by the government that apply to a future reporting period.

<sup>3</sup> GASB *Codification*, app. B; *Concept Statement No. 3*, par. 1.

3. Liabilities, which are present obligations to sacrifice resources that the government has little or no discretion to avoid.
4. Deferred inflows of resources, which are the acquisition of net assets by the government that apply to a future reporting period.
5. Net position, which is the residual when assets + deferred outflows of resources – liabilities – deferred inflows of resources is calculated (net position appears in a statement of financial position).
6. Inflow of resources, which is the acquisition of net assets by the government in the current reporting period (e.g., revenues and other resources).
7. Outflow of resources, which is the consumption of net assets by the government in the current reporting period (e.g., expenses, expenditures, and other uses of resources).<sup>4</sup>

The terms *inflow of resources* and *outflow of resources* are unique to government accounting and reporting standards, as are the terms *deferred inflows of resources* and *deferred outflows of resources*. Due to the GASB standards requiring two bases of accounting, the elements inflow of resources and outflow of resources were defined to accommodate both bases.

Although a deferred outflow of resources has the effect of increasing a government's net position, it does not meet the definition of an asset; thus, the GASB has created a separate element. Similarly, a deferred inflow of resources has the effect of decreasing a government's net position; however, it does not meet the definition of a liability. Deferred inflows and deferred outflows of resources are only used when required by a GASB standard. An example of a deferred inflow of resources would be resources received in a period prior to when the resources are to be applied (a timing issue). Because such an advance payment does not meet the definition of a liability, GASB standards require that it be recognized as a deferred inflow of resources. An advance debt refunding (covered in Chapter 6) could result in a deferred outflow (or inflow) of resources. If the resources used to refund the old bonds are greater than the net carrying value of the old bonds, a deferred outflow of resources results. The difference does not properly meet the definition of an asset, and it is not properly a "loss" because it relates to future periods over which the new debt has been substituted for the old debt.

In the financial reports, deferred inflows of resources and deferred outflows of resources are reported in separate sections of the balance sheet and/or statement of net position. As the different financial statements and the bases of accounting used by the financial statements are presented in future chapters, the characteristics and relationships of the elements will become apparent.

### Concepts Statement No. 6

In *Concepts Statement No. 6*,<sup>5</sup> the GASB indicates that those assets that are involved in the direct provision of services should be recorded and presented at the initial measurement amount. The initial amount is the transaction price or amount assigned when the asset is acquired (or a liability is reported). The GASB believes that the initial measurement amount is the amount most useful in providing information that can be used in determining the cost of services (e.g., capital assets). However, when assets

<sup>4</sup> GASB Codification, app. B; *Concepts Statement No. 4*, pars. 8, 17, 24, 32, 34, and 36. It should be noted that relatively few transactions will result in the recording of deferred outflows and deferred inflows of resources.

<sup>5</sup> GASB Codification, app. B.

are going to be converted to cash, *Concepts Statement No. 6* indicates that a remeasurement amount should be used. A remeasured amount is the amount assigned when an asset (or liability) is remeasured at the financial statement date. Remeasurement amounts are useful when trying to determine the availability of resources to acquire services or meet obligations (e.g., investments). For liabilities, the GASB believes that a remeasured amount is more useful for those liabilities for which the timing and amount of payments may be uncertain (e.g., compensated absences). When determining initial amounts and remeasurement amounts, *Concepts Statement No. 6* identifies four possible measurement attributes: historical cost, fair value, replacement cost, and settlement amount. As the financial statements are presented and various classes of assets and liabilities are discussed, you will notice some of the different measurement approaches and attributes reflected in the financial statements.

## ACTIVITIES OF GOVERNMENT

### LO 2-2

Explain the purpose of the three major activity categories of a state or local government:

- (1) governmental activities,
- (2) business-type activities, and
- (3) fiduciary activities.

One key difference between governments and for-profit business organizations is that governments are not profit seeking but exist to meet citizens' demand for services with the resources available to provide those services. As shown in Illustration 2–1, most general purpose governments engage in three broad categories of service activities: governmental, business-type, and fiduciary. Although the types and levels of services vary from government to government, general purpose governments provide certain core services: those related to protection of life and property (e.g., police and fire protection), public works (e.g., streets and highways, bridges, and public buildings), culture and recreation, and educational and social services. Governments also must incur costs for general administrative support such as data processing, finance, and personnel. Core government services, together with general administrative support, comprise the major part of what GASB *Concepts Statement No. 1* refers to as governmental-type activities.<sup>6</sup> In its more recent pronouncements, the GASB refers to these activities as simply **governmental activities**. Chapters 3 through 6 of the text focus on various aspects of accounting for governmental activities.

Some readers may be surprised to learn that governments also engage in a variety of **business-type activities**. These activities include, among others, public utilities (e.g., electric, water, gas, and sewer utilities), transportation systems, toll roads, toll bridges, hospitals, parking garages and lots, golf courses, and swimming pools. Many of these activities are intended to be self-supporting by charging users for the services they receive. Operating subsidies from general tax revenues are not uncommon,

### ILLUSTRATION 2–1 Activities of Government

Governmental	Business-type	Fiduciary
<ul style="list-style-type: none"> <li>Administrative support (e.g., city manager's office, personnel, data processing, and finance)</li> <li>Core government services (e.g., police and fire, public works, and culture and recreation)</li> </ul>	<ul style="list-style-type: none"> <li>Business-like activities that are largely self-supported by user charges (e.g., public utilities, transportation systems, airports, and golf courses)</li> </ul>	<ul style="list-style-type: none"> <li>Activities for which the government acts as a custodian or trustee for parties outside the government (e.g., as a custodian for billing and collecting taxes for other governments; as a trustee for employee pension plans and assets held in trust for the benefit of private parties)</li> </ul>

<sup>6</sup> GASB *Codification*, app. B; *Concepts Statement No. 1*, par. 10.

however, particularly for transportation systems. Accounting for business-type activities is covered in Chapter 7 of the text.

A final category of activity in which governments are involved is **fiduciary activities**. Governments often act in a fiduciary capacity, either as a custodian or trustee, for parties outside the government. For example, a government may serve as a custodian for other governments in administering and collecting taxes. Governments also may serve as a trustee for investments of other governments in the government's investment pool, for *escheat properties* that revert to the government when there are no legal claimants or heirs to a deceased individual's estate, and for assets being held for employee pension plans, among other trustee roles.

Under GASB standards, only custodial and trust relationships that benefit individuals, organizations, and other governments are reported as fiduciary activities. Activities with fiduciary characteristics that support the government's own programs, or provide residents or recipients with the government's goods and services, are treated as governmental activities for accounting and financial reporting purposes. Accounting for fiduciary activities is covered in Chapter 8 of the text.

## FINANCIAL REPORTING MODEL

### LO 2-3

Explain the Governmental Accounting Standards Board's (GASB) integrated accounting and financial reporting model.

As discussed in Chapter 1 (see Illustration 1–3), every state and local government should provide, at a minimum, basic financial statements, a management's discussion and analysis (MD&A), and certain other required supplementary information. To understand the basic principles of accounting and financial reporting for state and local governments, it is important to first understand the GASB's integrated accounting and financial reporting model. This model is depicted in Illustration 2–2. Key to the integrated model is the requirement to provide two kinds of basic financial statements, government-wide and fund; each kind is intended to achieve different reporting objectives.

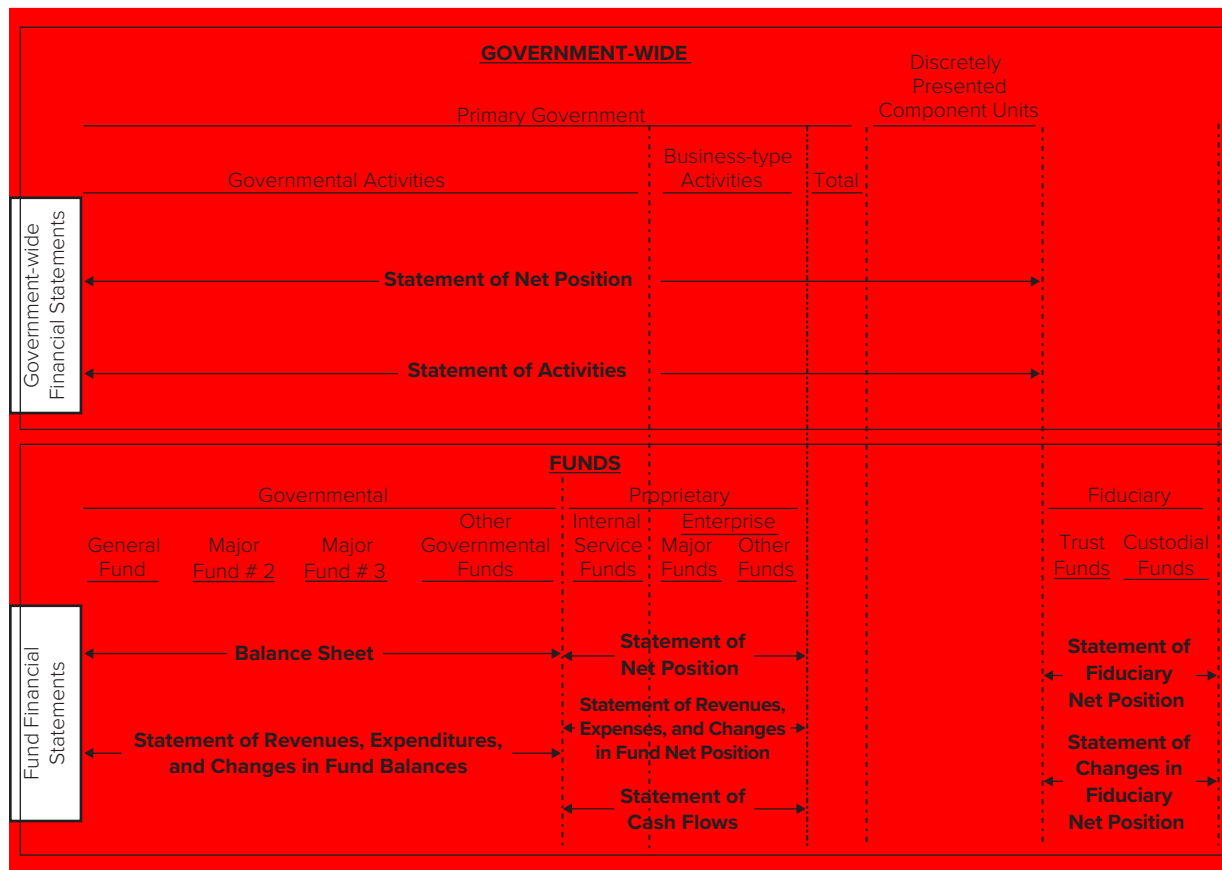
### Government-wide Financial Statements

The government-wide financial statements report on the government reporting entity as a whole but focus on the primary government. There are two required government-wide financial statements:

1. Statement of net position, and
2. Statement of activities.

As illustrated by the City and County of Denver, Colorado's government-wide financial statements (see Illustrations A2–1 and A2–2 in Appendix A at the end of this chapter), as well as Illustration 2–2, the government-wide statements present the financial information for the governmental activities and business-type activities of the primary government in separate columns, although there is a total column for the primary government. Illustration 2–2 shows that government-wide governmental activities align closely with the governmental funds, while business-type activities align closely with the proprietary enterprise funds. Due to the nature of activities reported by internal service funds, they are shown as aligning with and being reported as part of governmental activities. This relationship is discussed in more detail in **Chapter 7**. The City and County of Denver also presents financial information about certain independent organizations for which the primary government is considered to be financially accountable. This information is reported in the column captioned *Component Units*. Chapter 9 provides a detailed discussion of GASB reporting entity standards.



**ILLUSTRATION 2-2 The GASB Integrated Accounting and Financial Reporting Model**

The government-wide statements present all financial information using the **economic resources measurement focus** and the **accrual basis** of accounting—similar to the measurement focus and basis of accounting used in the financial statements of for-profit business organizations. Thus, as mentioned in Chapter 1, the government-wide financial statements report on the government's *operational accountability* and help to assess whether the government is covering the full cost of services over the long run.

The City and County of Denver's government-wide **statement of net position** (see Illustration A2-1) is essentially a balance sheet, which reports the government's fiscal year-end assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position.<sup>7</sup> Net position is the difference between total assets plus

<sup>7</sup> The City and County of Denver's financial statements provided in Appendix A and other excerpted information that is presented in later chapters are intended for illustrative educational purposes only. Omitted in this text are the auditor's report on the financial statements, the notes to the financial statements, and other required supplementary information. Moreover, depending on the time since this text was released, more current financial statements may be available. Those who have a need for financial information for credit analysis or other evaluative or decision purposes should refer to the City and County of Denver's audited financial statements in the comprehensive annual financial report (CAFR). The city's CAFR can be downloaded from <https://www.denvergov.org/content/denvergov/en/denver-department-of-finance/financial-reports/comprehensive-annual-financial-reports-cafr-.html>.