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Governmental and Nonprofit Accounting

Theory and Practice

PATRICIA DOUGLAS

Governmental and Nonprofit Accounting

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Patricia P. Douglas

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Preface

TEXT PURPOSE AND ORGANIZATION

Governmental and Nonprofit Accounting: Theory and Practice provides the fundamental knowledge necessary for understanding the operation of governmental and nonprofit entities, their accounting and financial reporting practices, and the standards that shape their accounting and financial reporting systems.

Accounting Practices

Because an appropriate balance between theory and practice is always an important goal, all governmental and nonprofit textbooks attempt to integrate theory and practice. This textbook uses an early emphasis on a conceptual framework for governmental accounting and financial reporting to introduce readers to that desirable blend of theory and practice. Chapters 1 and 2 expose them to the Governmental Accounting Standards Board's (GASB) concept statement and trace the evolution of that work in relation to earlier conceptual work done by the National Council on Governmental Accounting. These first two chapters also describe the efforts being made to develop generally accepted accounting principles from a conceptual framework.

Organization

Governmental accounting, financial reporting, and auditing are described in the first 12 chapters of this book. After assigning Chapters 1 to 3, which provide the fundamental concepts, professors may order the material to suit their particular needs. (This book is intended to be as current as possible. However, because governmental accounting is developing so rapidly, the instructor may want to update some topics as needed.)

Colleges and universities, hospitals, volunteer health and welfare organizations, and other nonprofit organizations are covered in Chapters 13–15. Similarities and differences among these organizations, and between them and governmental entities, are highlighted. Here too, chapters can be interchanged without any loss of efficacy.

Relation to Business Accounting

Most students who take a course in nonprofit accounting are already familiar with business accounting. And to avoid the burden of learning a “new accounting language,” this book frequently brings in the relationship between governmental or nonprofit accounting and business accounting. Chapter 3, for example, provides an overview of the significant similarities and differences between governmental and business accounting.

“New and Old” GAAP

Governmental accounting will soon change markedly. The GASB has issued its final pronouncement on the measurement focus and basis of accounting for governmental entities, with an effective date of 1994. Until then, and during the transition period, practitioners will need to know both current GAAP and new GAAP; therefore, each chapter covers both. The current GAAP is covered in an appendix to the appropriate chapters; the “1994 GAAP” is covered in the body of each chapter.

Capturing the Essence of Change

Because the rapidly evolving nature of governmental and nonprofit accounting is important to overall understanding, change constitutes a major focal point of the textbook. The Governmental Accounting Standards Board has passed the five-year structure review with its purview unchanged and its credibility substantiated. In addition to the recently completed measurement focus/basis of accounting project, the Board is addressing and expected to finalize soon standards relating to the reporting entity, capital assets, and propriety funds. Some of those may be finalized by the time this book is published.

The Financial Accounting Standards Board (FASB) is taking an increasingly active role in establishing accounting standards for the nonprofit organizations within its jurisdiction. Forthcoming standards related to financial reporting, contributions, and pledges all reflect the Board’s concern for the inconsistent accounting and reporting practices of nonprofit organizations.

Within the last few years, the American Institute of Certified Public Accountants has issued several auditing standards that relate directly or indirectly to governmental and nonprofit organizations. More are expected in the years ahead. The Institute is also in the process of revising several auditing guides related to these entities.

These rapid and fundamental changes in the accounting and financial reporting for governmental and nonprofit entities lend excitement to teaching and learning. Providing professors and students a guide to current accounting

and reporting practices and, at the same time, giving a flavor of possible future practices was also challenging.

Pedagogy

Governmental and Nonprofit Accounting provides an extensive array of pedagogic elements. Each chapter ends with both review questions and exercises. Additionally, the book offers cases that allow discussion of practical and theoretical issues to create an awareness of the accounting and standard-setting environment impossible to achieve with problems and exercises alone.

The review questions tend to focus on specific issues and can be used to reinforce major points made in the text. Most exercises integrate several concepts and are especially useful for providing a broader review of the chapter material. Most chapters in Part 1 also contain an exercise related to the financial statements of Raleigh, North Carolina, which appear in the Appendix to the book. This continuing example helps relate the separate topics to one another.

Observation Blocks

Fact and editorial license are often confused in textbooks. To avoid that confusion and to add an occasional theoretical or practical implication, the text is sprinkled with personal observations. And they are clearly marked as such. Students who have used this book in draft form have commented that these made the “text come alive” or “the theory clearer.” They also represent yet another attempt to blend theory and practice.

ANCILLARY MATERIALS

A Solutions Manual and Test Bank accompany the textbook. The Test Bank includes true–false, multiple-choice, and essay questions, as well as miscellaneous problems and exercises. Solutions to all Test Bank questions are provided, with detailed calculations where appropriate.

ACKNOWLEDGMENTS

This textbook has only one author who assumes responsibility for the accuracy and quality of the material. Many people, however, helped make it better than it would otherwise have been. First among them is professor Robert Anthony, whose incisive observations and critical questions helped better define both my thinking and the structure of the text. His vast experience also made his editorial work invaluable.

As I do, students and professors who use the book should thank the more than 350 students who spent hundreds of hours evaluating the ease with which the material can be understood and the relationship between the text and the end-of-chapter materials.

Two other students, Susan Mowrer and Shannon Hensler, merit special attention for, respectively, patiently checking the end-of-chapter solutions and preparing the index. The moral support and encouragement received from several faculty members and administrators, including Teresa Beed, Bruce

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Harcourt Brace Jovanovich editors Bill Teague and Ken Rethmeier were understanding and helpful to an author who is somewhat impatient with the rules and skeptical of the process. And final editing touches were expertly added by Ellen Tweedy.

Without the dedicated assistance of Joyce Watson and various City of Raleigh officials, the Appendix would never have been available for use in this textbook.

My thanks go as well to those reviewers who made useful observations and helpful comments: Nicholas G. Apostolou, Louisiana State University; Larry Bailey, Rider College; and Alexander E. C. Yuen, San Francisco State University.

I am deeply and forever grateful to my husband Chuck and my mother Phyllis; they picked up the slack during these past three years and never voiced the obvious question; Will you ever be done with this book? It is because of your forbearance that I have completed this project.

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Introduction to Governmental Accounting Section

Chapters 1–12 describe accounting and financial reporting for governmental entities. The environment in which governmental units operate and the general concepts and accounting principles are discussed in the first two chapters. Chapter 3 gives a broad overview of the differences between accounting for governments and businesses.

Beginning with Chapter 4 and ending with Chapter 9, each individual fund and account group used in governmental accounting is described in detail, along with the general reporting practices of each one. Because the basis of accounting for many of these funds will change in 1994, the text provides guidance to the reader for both pre-1994 and post-1994 standards. The post-1994 standards are described in the body of the chapter, and the pre-1994 standards are described in the appendix to each chapter.

Chapter 10 covers the annual and interim financial reporting requirements for governmental entities. It includes illustrations of the various financial statements and describes the format and inclusions for the comprehensive annual financial report.

Auditing considerations relating to governmental units are discussed in Chapter 11, including the requirements of the Single Audit Act. Generally accepted auditing standards for governmental entities are described, and illustrative footnote disclosures are provided.

The final chapter in this section, Chapter 12, covers several important current topics in the governmental area. The continued concern over the jurisdiction of the Governmental Accounting Standards Board and the Financial Accounting Standards Board is one such topic. Others include pension accounting and the accounting and reporting for general fixed assets.

Governmental accounting is changing rapidly. It will continue to do so in the foreseeable future. The first section of the textbook provides direction to those who will be examining these changes. It also will help those making the transition from current, generally accepted accounting principles to the principles applicable after 1994.

Nonprofit Entities: An Overview of Accounting, Reporting, and Auditing

Governmental and other nonprofit entities are a critically important force in our society. The federal government alone employs 3 million people, and its annual budget exceeds \$1 trillion. In addition, local governments (states, counties, cities, towns, and school districts) spend billions of dollars and employ over 14 million workers. Nonprofit organizations such as hospitals, colleges and universities, foundations, churches, health care organizations, and a host of others also spend considerable sums and employ a substantial work force.

No matter what occupation, locale, or status one has, everyone comes into daily contact with nonprofit entities. When paying taxes, attending school, using public services, or working for local charities, people contribute to or benefit from these organizations.

The pervasive influence and economic significance of nonprofit organizations require the public to understand how they are organized and managed, and how they can be held accountable for the resources they spend. Accountants, in particular, need that understanding because they audit nonprofit organizations or prepare the information that others will audit. In addition, accountants frequently are called upon to assist laypersons in interpreting financial statements and to develop ways in which performance can be improved.

Chapters 1 and 2 of this text define the environment and character of nonprofit entities. In this first chapter, the external environment is discussed. The importance of nonprofit entities and their impact on society are briefly described. This chapter also covers the standard-setting process for nonprofit organizations: its historical development, significance, and current status. Another major topic covered is the nature and scope of auditing in the nonprofit area, including a description of the forces that are expanding the audit function.