



Sixth Edition

Essentials of
Accounting for
Governmental and
Not-for-Profit
Organizations

John H. Engstrom
Paul A. Copley

ESSENTIALS OF ACCOUNTING FOR GOVERNMENTAL AND NOT-FOR-PROFIT ORGANIZATIONS

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*This book is dedicated to
Leon Hay,
co-author of the first five editions of this text;
mentor, colleague, and friend.*

PREFACE

The preface to the first five editions of this text noted that the text was intended to provide a much more comprehensive coverage of accounting and financial reporting for governmental and not-for-profit accounting than is available in Advanced Accounting texts but that would be brief enough to allow coverage of the material in less than a three-semester-hour or four-quarter-hour course. The first five editions have been well received by instructors whose objective is to provide less detailed coverage than is available in larger texts, such as *Accounting for Governmental and Nonprofit Entities* by Hay, Wilson, and Kattelus (McGraw-Hill/Irwin, 12th edition) as well as those whose objective is to stress preparation for the CPA Examination. The text is also used by some who wish to supplement basic accounting and reporting principles with other materials.

This edition of the text and the accompanying *Instructor's Guide* and the *Suggested Quiz and Examination Questions and Problems* booklet have been revised in accord with suggestions of users of the first five editions and to incorporate changes in standards issued by the GASB, FASB, and AICPA. This edition is a major revision.

First, the text reflects the changes in accounting and reporting for state and local governments and for public colleges and universities brought about by GASB *Statements* 33, 34, and 35. The text presents materials based on the new reporting model. A particular approach has been used, which the authors believe will be the way governments will account and report. The assumption is made that fund accounting will be the basic model used for internal accounting and for part of the external reporting. Then, worksheet adjustments will be made to produce the government-wide statements. After the introductory Chapter 1, Chapter 2 presents an overview of the financial reporting model. Chapter 3 presents budgetary accounting for the General and special revenue funds, leading to the Budgetary Comparison schedule. Fund accounting and reporting are then presented for governmental (Chapters 4–5), proprietary (Chapter 6) and fiduciary (Chapter 7) funds. Chapter 8 presents a worksheet approach for the preparation of government-wide statements and reconciliation schedules. As has been the case for the first five editions, an integrated example (the Village of Elizabeth) is presented throughout as well as an integrated continuous problem. Chapter 9 presents public college reporting in accord with GASB *Statement* 35.

Second, the not-for-profit chapters (Chapters 10, 11, and 12) have been modified to recognize the fact that assets and liabilities are common to all net asset classes. These chapters on general not-for-profits, private colleges and universities, and health care entities are presented more simply and clearly than in past editions. Chapter 13 provides coverage for issues relating to auditing, taxation of not-for-profit organizations, and service efforts and accomplishments.

The authors are indebted to members of the Governmental Accounting Standards Board and to the GASB research staff for access to their thinking, as well as permission to use GASB materials. The authors also wish to express their appreciation to the American Institute of Certified Public Accountants and the Financial Accounting Standards Board for permission to use materials.

The authors would especially like to acknowledge Professor Leon Hay, Distinguished Professor Emeritus of Accounting of the University of Arkansas—Fayetteville, for the contributions made to the first five editions of this text. Professor Hay has been a mentor to Professor Engstrom for many years and his guidance is valued greatly.

The authors would appreciate suggestions from users of this text for improvements in presentation of this material and suggestions for additional or improved questions and exercises. Please send suggestions to Jengstrom@niu.edu or Pcopley@terry.uga.edu.

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Chapter 1

INTRODUCTION TO ACCOUNTING AND FINANCIAL REPORTING FOR GOVERNMENTAL AND NOT-FOR-PROFIT ORGANIZATIONS

Governments differ from business organizations discussed in other accounting courses in that governments have no stockholders or other owners, they render services with no expectation of earning net income, and they have the power to require taxpayers to support financial operations whether or not the taxpayers receive benefits in proportion to taxes paid. Also, governments are not subject to federal, state, or local income taxes. Further, the form of government in the United States requires interrelationships that have no parallel in business organizations, between a state government and local governments established in compliance with state law and within any one government between the executive and legislative branches. Similarly, nongovernmental not-for-profit organizations exist to render services to constituents with no expectation of earning net income from those services, have no owners, and seek financial resources from persons who do not expect either repayment or economic benefits proportionate to the resources provided.

Accounting and financial reporting standards for the federal government are recommended by the Federal Accounting Standards Advisory Board (FASAB). Recommendations of the FASAB are reviewed and approved by the

U.S. General Accounting Office (GAO), the U.S. Department of the Treasury, and the U.S. Office of Management and Budget (OMB). These standards apply to financial reports issued by federal agencies and to the Consolidated Financial Report of the United States Government. Accounting and financial reporting standards for the federal government are beyond the scope of this book but are available at <http://www.financenet.gov/fasab.htm>.

Accounting and financial reporting standards for state and local governments in the United States are set by the Governmental Accounting Standards Board (GASB). The GASB also sets accounting and financial reporting standards for governmentally related not-for-profit organizations, such as colleges and universities, health care entities, museums, libraries, and performing arts organizations that are owned or controlled by governments. Accounting and financial reporting standards for profit-seeking businesses and for nongovernmental not-for-profit organizations are set by the Financial Accounting Standards Board (FASB). The GASB and the FASB are parallel bodies under the oversight of the Financial Accounting Foundation (FAF). The FAF appoints the members of the two boards and supports the operating expenses of the boards by obtaining contributions from business corporations; professional organizations of accountants, financial analysts, and other groups concerned with financial reporting; CPA firms; debt-rating agencies; and state and local governments (for support of the GASB). Because of the breadth 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 bodies in the private sector.” Standards set by the FASAB, GASB, and FASB are the primary sources of **generally accepted accounting principles (GAAP)** as the term is used in accounting and auditing literature.

FASAB, GASB, and FASB standards are set forth primarily in documents called **Statements**. From time to time, the boards find it necessary to expand on standards in documents called **Interpretations**. Boards also issue **Technical Bulletins** to explain the application of standards in certain situations or industries. Independent auditors are engaged to express their opinion that the financial statements of a client present fairly, in all material respects, the client’s financial position as of the end of a fiscal year and the results of its operations and its cash flows for the year then ended, in conformity with generally accepted accounting principles (GAAP). Since FASAB, GASB, and FASB Statements, Interpretations, and Technical Bulletins do not cover all possible situations, auditors often have need to refer to other publications. However, these other publications do not take precedence over Statements and Interpretations. Illustration 1-1 presents the hierarchy of GAAP published by the American Institute of Certified Public Accountants for the guidance of independent auditors.

Some organizations possess certain characteristics of both governmental and nongovernmental not-for-profit organizations, and it is necessary to determine whether those organizations are governmental or nongovernmental for purposes of applying GAAP, in accord with the hierarchy shown in

Illustration 1-1. Recently, the FASB and GASB agreed upon a definition of a government. As reproduced in the *AICPA Audit and Accounting Guide: Not-for-Profit Organizations*, the definition is as follows:

Public corporations and bodies corporate and politic are governmental organizations. Other organizations are governmental organizations if they have one or more of the following characteristics:

- a. Popular election of officers or appointment (or approval) of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments;
- b. The potential for unilateral dissolution by a government with the net assets reverting to a government; or
- c. The power to enact and enforce a tax levy.

Furthermore, organizations are presumed to be governmental if they have the ability to issue directly (rather than through a state or municipal authority) debt that pays interest exempt from federal taxation. However, organizations possessing only that ability (to issue tax-exempt debt) and none of the other governmental characteristics may rebut the presumption that they are governmental if their determination is supported by compelling, relevant evidence.

OUTLINE OF THE TEXT

The remainder of this chapter and Chapters 2 through 9 are concerned with accounting and financial reporting standards—generally accepted accounting principles—applicable to state and local governments in the United States. Chapter 9 covers new GASB standards for public colleges and universities. Chapters 10 through 12 discuss and illustrate FASB and AICPA standards for nongovernmental not-for-profit organizations—general not-for-profit organizations, private colleges and universities, and health care entities. Finally, Chapter 13 is concerned with three topics essential to an overall understanding of governmental and not-for-profit accounting: (1) the unique aspects of auditing for these organizations, (2) taxation of exempt entities, and (3) service efforts and accomplishments.

OBJECTIVES OF ACCOUNTING AND FINANCIAL REPORTING

All three standards-setting organizations—the Federal Accounting Standards Advisory Board, the Financial Accounting Standards Board, and the Governmental Accounting Standards Board—take the position that the establishment of accounting and financial reporting standards should be guided by conceptual considerations so that the body of standards is internally consistent and the standards address broad issues expected to be of importance for a significant period of time. The cornerstone of a conceptual framework is said to be a statement of the objectives of financial reporting.

ILLUSTRATION 1-1 GAAP Hierarchy Summary

Established Accounting Principles			Federal Government	
Nongovernmental Entities			State and Local Governments	
FASB Statements and Interpretations, APB Opinions, and AICPA Accounting Research Bulletins	GASB Statements and Interpretations, plus AICPA and FASB pronouncements if made applicable to state and local governments by a GASB Statement or Interpretation	FASB Statements and Interpretations plus AICPA, FASB, and GASB pronouncements if made applicable to federal governmental entities by a FASAB Statement or Interpretation		
FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position	GASB Technical Bulletins and the following pronouncements if specifically made applicable to state and local governments by the AICPA: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position	FASB Technical Bulletins and the following pronouncements if specifically made applicable to federal governmental entities by the AICPA and cleared by the FASAB: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position		
Consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins	Consensus positions of the GASB Emerging Issues Task Force ² and AICPA Practice Bulletins if specifically made applicable to state and local governments by the AICPA	AICPA AcSEC Practice Bulletins if specifically made applicable to federal governmental entities and cleared by the FASAB and Technical Releases of the Accounting and Auditing Policy Committee of the FASAB		
AICPA accounting interpretations, "Qs and As" published by the FASB staff, as well as industry practices widely recognized and prevalent	"Qs and As" published by the GASB staff, as well as industry practices widely recognized and prevalent	Implementation guides published by the FASAB staff and practices that are widely recognized and prevalent in the federal government		