CHAPTER 1: INTRODUCTION TO ACCOUNTING AND FINANCIAL REPORTING FOR GOVERNMENT AND NOT-FOR-PROFIT ENTITIES

**OUTLINE**

|  |  |  |  |
| --- | --- | --- | --- |
| **Number** | **Topic** | **Type/Task** | **Status**  **(re: 17/e)** |
| **Questions:** |  |  |  |
| 1-1 | Differences between types of organizations | Identify | Same |
| 1-2 | Distinguishing between general purpose and special purpose governments | Identify | Same |
| 1-3 | Standards-setting bodies | Identify | Same |
| 1-4 | Determining which standard-setting body sets standards for a nongovernmental NFP | Categorize | Same |
| 1-5 | Nature and significance of *interperiod equity* | Explain | Same |
| 1-6 | Determining the purpose of the two types of accountability | Determine | Same |
| 1-7 | Primary reporting objectives for NFPs and governments | Compare | Same |
| 1-8 | Comprehensive annual financial report | Recognize | Same |
| 1-9 | Federal government performance and accountability report | Identify/Describe | Same |
| 1-10 | NFP reporting of expenses | Explain | Same |
| **Cases:** |  |  |  |
| 1-11 | Research Case—GASB | Apply | New |
| 1-12 | Research Case—GASB | Summarize | 1-11 |
| 1-13 | Research Case—FASB | Summarize | New |
| 1-14 | Research Case—FASB | Analyze | New |
| 1-15 | Research Case—FASAB | Summarize | 1-13 |
| 1-16 | Research Case—Federal Financial Reporting Objectives | Analyze | 1-15 |
| **Exercises/Problems:** | | |  |
| 1-17 | Examine the CAFR | Examine | 1-16 |
| 1-18 | Financial Statement Differences | Differentiate | 1-17 revised |
| 1-19 | Various | Multiple Choice | 1-18 item 9 is new; other items are the same or revised |
| 1-20 | Matching concepts and reporting characteristics or requirements for governmental and NFP organizations | Classify | 1-19 revised |
| 1-21 | Matching standards governing organizations | Classify | New |

**CHAPTER 1: INTRODUCTION TO ACCOUNTING AND FINANCIAL REPORTING FOR GOVERNMENT AND NOT-FOR-PROFIT ENTITIES**

Answers to Questions

1-1. Following is a list of some of the differences between business organizations and government/not-for-profit organizations.

|  |  |
| --- | --- |
| **Business Organizations** | **Government/Not-for-for profit Organizations** |
| Providers of resources expect either repayment or economic benefits proportionate to the resources provided. | Many providers of resources do not expect repayment or economic benefits proportionate to the resources provided. |
| Primary operations are undertaken to provide goods or services at a profit. | Primary operations are not undertaken to provide goods or services at a profit or profit equivalent. |
| There are defined ownership interests that can be sold, transferred or redeemed or entitle the owner to a share of remaining resources at liquidation. | There are no defined ownership interests. |

**General Problem Information:** Differences between types of organizations

**Learning Objective:** 1-1

**Topic:** Distinguishing Characteristics of Governmental and Not-for-Profit Entities

**Bloom’s Taxonomy:** Remember

**Accreditation Skills tag:** AACSB: Communication,AICPA: BB Industry

**Level of Difficulty:** Easy

1-2. *a*. GP *c*. SP *e*. SP

*b*. SP *d*. GP *f*. GP

**General Problem Information:** Distinguishing between general purpose and special purpose governments

**Learning Objective:** 1-1

**Topic:** What are Governmental and Not-for-profit Organizations?

**Bloom’s Taxonomy:** Remember

**Accreditation Skills tag:** AACSB: Communication,AICPA: BB Industry

**Level of Difficulty:** Easy

Ch. 1, Answers (Cont’d)

1-3. Illustration 1-1 depicts the standard-setting jurisdiction of the FASB, GASB and FASAB. As shown, the FASB has responsibility for setting accounting and financial reporting standards for business enterprises and *nongovernmental* not-for-profit organizations. The GASB has responsibility for setting standards for state and local governments and *governmental* not-for-profit organizations. The FASAB has responsibility for setting accounting and reporting standards for the federal government and its agencies and departments.

**General Problem Information:** Standards-setting bodies

**Learning Objective:** 1-2

**Topic:** Sources of Financial Reporting Standards

**Bloom’s Taxonomy:** Remember

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Easy

1-4. No, I do not agree with this board member’s statement. Since Beth House Museum is a nongovernmental not-for-profit organization, it is required to follow the standards issued by FASB. Since its purpose is not the same as a business organization, FASB has developed reporting standards for organizations such as Beth House Museum that reflect its unique purpose and users. Governmental not-for-profit organizations must follow GASB financial reporting standards. (See illustration 1-1.)

**General Problem Information:** Determining which standard-setting body sets standards for a nongovernmental NFP

**Learning Objective:** 1-2

**Topic:** Sources of Financial Reporting Standards

**Bloom’s Taxonomy:** Understand

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Medium

1-5. Interperiod equity, whether current period revenues are sufficient to pay for current period services, is an important component of accountability. Failure to pay for current period services means that the financial burden is being passed to future year taxpayers who may not receive any benefit from the past services.

**General Problem Information:** Nature and significance of *interperiod equity*

**Learning Objective:** 1-3

**Topic:** Objectives of Financial Reporting

**Bloom’s Taxonomy:** Understand

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Medium

Ch. 1, Answers (Cont’d)

* 1. The purpose of *operational accountability* is to assess whether the government has used its resources efficiently and effectively in meeting its operating objectives. The purpose of *fiscal accountability* is to assess the short-term flow of current financial resources. Government–wide financial statements are primarily focused on providing information to assess operational accountability, while fund financial statements are focused on providing information to assess fiscal accountability.

**General Problem Information:** Determining the purpose of the two types of accountability

**Learning Objective:** 1-4

**Topic:** Financial Reporting of State and Local Governments

**Bloom’s Taxonomy:** Understand

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Medium

* 1. The primary financial reporting objective for not-for-profit organizations is to provide decision-useful financial information to resource providers, such as donors, members, and creditors. The primary financial reporting objective for a government organization is accountability, but other objectives include providing useful information for economic, social, and political decisions. Thus, the reporting focus for the two types of organizations differs in that the not-for-profit organization financial reports are to focus on providing information that is useful in making decisions; while the government organization is to focus primarily on providing information that can be used to assess whether public resources were raised and used for their intended purposes.

**General Problem Information:** Primary reporting objectives for NFPs and governments

**Learning Objective:** 1-3

**Topic:** Objectives of Financial Reporting

**Bloom’s Taxonomy:** Understand

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Medium

* 1. A CAFR should have an introductory section, financial section, and statistical section. The contents of each section are described briefly in the section headed “Comprehensive Annual Financial Report.” Minimum requirements for general external financial reports are but a portion of the content of the CAFR. The minimum requirements of the general external financial report include the basic financial statements and related notes (government-wide and fund), management’s discussion & analysis (MD&A), and other required supplementary information (RSI). As can be seen, the minimum requirements for the general external financial report do not include an introductory section, other supplementary financial information, or a statistical section.

Ch. 1, Answers, Question 1-8 (Cont’d)

**General Problem Information:** Comprehensive annual financial report

**Learning Objective:** 1-4

**Topic:** Financial Reporting of State and Local Governments

**Bloom’s Taxonomy:** Remember

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Easy

* 1. The four sections of a federal agency’s *performance and accountability report* (PAR) are (1) an MD&A, which provides a brief overview of the entire PAR and describes the agency’s mission and performance goals, among other items; (2) the performance section, essentially consisting of the agency’s annual performance report (APR); (3) the basic financial statements, which are listed in this chapter; and (4) other accompanying information, such as information about the nation’s tax burden, the tax gap, challenges facing the agency’s management, and revenue forgone.

**General Problem Information:** Federal government performance and accountability report

**Learning Objective:** 1-5

**Topic:** Financial Reporting of the Federal Government

**Bloom’s Taxonomy:** Remember

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Easy

* 1. Reporting program expenses separately from management and general expenses and fund-raising costs provides information to donors, members and oversight bodies to assess the effectiveness of the organization in accomplishing its purpose. Most donors and members wish to have the funds they contribute used for the organizational purpose rather than supporting management costs or fund-raising expenses. This reporting is also necessary for oversight bodies, such as the Internal Revenue Service, to permit the continued existence of the organization as a not-for-profit.

**General Problem Information:** NFP reporting of expenses

**Learning Objective:** 1-5

**Topic:** Financial Reporting of Not-for-profit Organizations (NFPs)

**Bloom’s Taxonomy:** Understand

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Medium

Ch. 1, Solutions

Solutions to Cases

* 1. Instructors may wish to provide specific instructions for the format of the students' brief reports. Only some of the topics covered in the White Paper have been identified for this assignment.

Capital assets – for-profits acquire capital assets to generate future cash flows (revenues that create wealth); whereas, the capital assets of a government are used to provide services to citizens. As a result, the valuation of capital assets is reported with different objectives in mind. If a capital asset of a for-profit experiences a reduction in service potential it is assessed and measured for possible impairment. With a government the valuation of the capital asset will be assessed and measured for impairment if the asset experiences a reduction in service potential.

Major revenue sources – for-profits’ major revenue is generated from the goods or services provided in exchange transactions. As a result, the principle for recognizing revenue under the FASB standard is: “Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” This is unlike governments that depend heavily on taxes or non-exchange revenues. Since

property taxes are non-exchange transactions the same rules as are used for recognition of revenue by for-profit organizations cannot apply in that there is frequently no transfer of promised goods or services. For this reason, the government will recognize and report tax revenue in the period that the costs of providing the services for which the taxes were levied are provided.

**General Problem Information:** Research Case—Understanding why government reporting standards are different

**Learning Objective:** 1-1

**Topic:** Distinguishing Characteristics of Government and Not-for-profit Organizations

**Bloom’s Taxonomy:** Apply

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Research

**Level of Difficulty:** Medium

* 1. Instructors may wish to provide specific instructions for the format of the students' brief reports. The GASB’s Web site ([www.gasb.org](http://www.gasb.org)) provides extensive information about the Board’s mission, structure, the due process it follows in setting standards, and the role of its advisory council, the Governmental Accounting Standards Advisory Council (GASAC). Significant information about the GASB’s strategic plan is also provided at the Web site.

The GASB *Codification of Governmental Accounting and Financial Reporting Standards* is available for purchase from its Web site in either hardcopy or as a searchable online system called GARS, the Governmental Accounting Research System. Those colleges and universities with an access code for the online FASB Accounting Standards

Ch. 1, Solutions, Case 1-12 (Cont’d)

Codification will also be able to access GARS. At the time of this edition’s publication, the GASB also sells an annually updated compendium of its official pronouncements—*Original Pronouncements* and an annually updated *Comprehensive Implementation Guide*. The GASB’s Web site provides full information on how to order all publications and their cost, as well as information about becoming an annual subscriber to GASB pronouncements and due process documents.

**General Problem Information:** Research Case—Understanding GASB

**Learning Objective:** 1-2

**Topic:** Sources of Financial Reporting Standards

**Bloom’s Taxonomy:** Summarize

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Research

**Level of Difficulty:** Medium

* 1. Instructors may wish to provide specific instructions for the format of the students' brief reports. The objective of this case is to provide students with a better understanding of how the financial reports have changed, given that some of them may see “old” formats when conducting audits or working with NFP organizations.

Statement of Net Assets – the net asset classifications changed from three to two. Under the prior standard the three classifications were temporarily restricted, permanently restricted, and unrestricted. The change resulted in the two classifications, net assets with donor-imposed restrictions and net assets without donor-imposed restrictions.

Statement of Activities – rather than showing the changes in the three net asset classifications the statement will now show changes in the two net asset classifications. Additionally, the preparer may opt to report expenses by functional and natural classification on the statement of activities (other options would be a schedule in the notes or a separate financial statement).

Statement of Cash Flows – the statement can still be prepared using either the direct or the indirect method; however, if the direct method is used the preparer need no longer include the reconciliation of net income to net operating cash.

**General Problem Information:** Research Case—FASB NFP reporting standards changes

**Learning Objective:** 1-5

**Topic:** Financial Reporting of Not-for-profit Organizations

**Bloom’s Taxonomy:** Summarize

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Research

**Level of Difficulty:** Medium

* 1. Instructors may wish to provide specific instructions for their students' brief reports.

Unlike for-profit organizations, not-for-profit organizations do not have a profit indicator such as net income to help users in determining how to allocate their scarce resources.

Ch. 1, Solutions, Case 1-14 (Cont’d)

For this reason it is important that financial reports assist the users in determining not only that management has kept safe the assets of the organization but that it has also efficiently and effectively used the assets to meet and grow the organization’s mission. In addition, effective stewardship means the management has complied with all legal and contractual responsibilities.

**General Problem Information:** Research Case—FASB NFP reporting objectives

**Learning Objective:** 1-3

**Topic:** Objectives of Financial Reporting

**Bloom’s Taxonomy:** Analyze

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Research

**Level of Difficulty:** Difficult

* 1. Instructors may wish to provide specific instructions for their students' brief reports. FASAB’s Web site may change over time, but the Web site does provide extensive information about the board’s mission, structure, and due process. A good source of information is the Memorandum of Understanding between the Comptroller General, Director of OMB, and the Secretary of the Treasury that created the FASAB, which currently is a 9-member board. Because FASAB’s technical projects and members of the Accounting and Auditing Policy Committee will change over time, students should describe the projects and committee representation that currently exist.

All statements and other pronouncements of the FASAB are contained in a compendium of all original pronouncements called *Pronouncements as Amended* and are available for downloading from its Web site at no charge. All due process documents are available at that site as well.

**General Problem Information:** Research Case—Understanding FASAB

**Learning Objective:** 1-2

**Topic:** Sources of Financial Reporting Standards

**Bloom’s Taxonomy:** Summarize

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Research

**Level of Difficulty:** Medium

* 1. Instructors may wish to provide specific instructions for the format of the students’ brief reports. The four major groups of users identified by the board are citizens, Congress, executives, and program managers.

Citizens – Citizens pay for and receive government services. Therefore, they are interested in individual government programs, candidates for office, and the fiscal and operational accountability of their elected officials. They want to know what services are provided, and what the outputs or outcomes of the services are, as well as the efficiency and effectiveness with which they are provided.

Ch. 1, Solutions, Case 1-16 (Cont’d)

Congress – Congress is concerned with broad policies, priorities and the programs that implement the priorities. It is responsible for imposing taxes, and determining the amount of funds that should be spent and the purposes of the expenditures. Congress is concerned with how to finance and execute programs. It also assists in monitoring and assessing the effectiveness and efficiency of programs, as well as evaluating the management performance of the executive branch.

Executives – Executives focus on strategic plans and programs to accomplish specific goals and implement policies. One primary focus is on budgets, which are used to provide funding for these plans and programs. They propose funding amounts to Congress and develop plans for financing and generating revenues to provide the funding. They are also concerned with the efficiency and effectiveness of plans and programs.

Program Managers – Program managers assist in the design and delivery of program objectives, and provide input into funding requirements. They must manage their programs within the budget approved by Congress.

The four objectives identified are budgetary integrity, operating performance, stewardship and systems and controls. Students should be able to make connections between the needs of the user groups and the objectives identified.

**General Problem Information:** Research Case—Federal Financial Reporting Objectives

**Learning Objective:** 1-3

**Topic:** Objectives of Financial Reporting

**Bloom’s Taxonomy:** Analyze

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Hard

Ch. 1, Solutions (Cont’d)

Solutions to Exercises and Problems

* 1. As students may have different CAFRs, there is no single solution to this exercise. It works well to devote class time to asking students some of the questions listed in the exercise, and perhaps tabulating the number of reports containing statements that are audited (1) by CPAs, (2) by state auditors, and (3) by employees of the reporting government. If such a tabulation is made, students may be interested in knowing in which states the local governmental units are located that are audited by each of the classes of auditors (or whatever other characteristic is being tabulated). Requiring that students download a CAFR is a good exercise in obtaining financial information. Allow students to share their experiences, as some governments make it easier to get CAFRs than others. Remind students that governments are not required to prepare a full CAFR, so some governments may simply refer to their report as the “audited annual financial statement,” or even the “audit report.”

**General Problem Information:** Examine the CAFR

**Learning Objective:** 1-4

**Topic:** Financial Reporting of State and Local Governments

**Bloom’s Taxonomy:** Remember

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Easy

1-18. Although the major similarities and differences have been provided, students will undoubtedly also find additional items that you may wish to discuss.

1. The following represent some of the similarities and differences in Denver’s Statement of Net Position and the Promote Health Association’s (PHA) Balance Sheet.

Similarities

* Both have an Assets, Liabilities, and a Net Assets/Net Position section
* Both list assets in the order of liquidity
* Both list current liabilities prior to noncurrent liabilities

Dissimilarities

* Denver does not provide a comparative year as does the PHA
* Denver lists a primary government and divides it into two columns – governmental activities and business-type activities. It then also includes a component units column. The PHA has only one column for the year’s activity.
* Denver has additional sections in its statement called Deferred Outflows of Resources (this appears below Total Assets) and Deferred Inflows of Resources (this appears below the Total Liabilities). The PHA has nothing similar to this.

Ch. 1, Solutions, Exercise 1-18 (Cont’d)

* Denver uses net position rather than net assets and divides the net position into net investment in capital assets, restricted, and unrestricted. However, the PHA uses the term net assets and divides the net assets into net assets with donor restrictions and net assets without donor restrictions.

1. Other than the name there are very few similarities between Denver’s Statement of Activities and the PHA’s Statement of Activities. Listed below are some similarities and differences.

Similarities

* Both use the terms revenues and expenses.
* Both list revenues by sources and expenses by function.
* Both add beginning net assets/position to the change in net assets/position to arrive at the ending net assets/position.

Dissimilarities

* Denver divides its revenues into program revenues (charges for services, operating grants and contributions, and capital grants and contributions) and general revenues, whereas the PHA divides its revenues into contributions and grants, and fees from exchange transactions.
* The PHA divides its expenses into program activities and supporting services; whereas, Denver does not make this distinction.
* The general format of the statements is different with Denver starting the statement by listing expenses from which it deducts program revenues and general revenues. The PHA uses the traditional format, starting with revenues and deducting expenses.
* As with the statement of net position, Denver includes separate sections for governmental activities, business-type activities, and component units.
* The PHA includes separate columns showing the activity in each of its net asset components – net assets with donor restrictions and net assets without donor restrictions. Denver does not show activity by net position component.

**General Problem Information:** Financial Statement Differences

**Learning Objective:** 1-4

**Learning Objective:** 1-5

**Topic:** Financial Reporting of State and Local Governments; Financial Reporting of Not-for-profit Organizations

**Bloom’s Taxonomy:** Analyze

**Accreditation Skills tag:** AACSB: Knowledge Application,AICPA: FN Reporting

**Level of Difficulty:** Hard

Ch. 1, Solutions (Cont’d)

1-19. 1. *c.* 6. *b*.

2. *b.* 7. *b*.

3. *b*. 8. *d.*

4. *d*. 9. *c*.

5. *c*. 10. *d*.

**General Problem Information:** Various

**Learning Objective:** 1-1

**Learning Objective:** 1-2

**Learning Objective:** 1-3

**Learning Objective:** 1-4

**Learning Objective:** 1-5

**Learning Objective:** 1-6

**Topic:** Various chapter topics

**Bloom’s Taxonomy:** Remember

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Easy

* 1. This is an exercise that may generate considerable discussion in class, as some of the answers will be absolutely true and others partially true, depending on individual judgments and interpretations. Keeping this in mind, you may wish to provide some leeway in grading this exercise, depending on how literally you interpret the particular item’s relationship to type of organization.

|  |  |  |  |
| --- | --- | --- | --- |
| **Characteristic, Concept, or Financial Reporting Requirement** | **State and Local Governments** | **Federal Government** | **Nongovernmental Not-for-profit Organizations** |
| Accountability is the foundation of financial reporting | Y | Y | N |
| Management’s discussion and analysis (MD&A) | Y | Y | N |
| Performance & accountability report | N | Y | N |
| Stewardship is identified as a financial statement purpose | N | Y | Y |
| A concern with budgetary compliance | Y | Y | N |
| Absence of defined ownership interests | Y | Y | Y |
| Standards set by GASB | Y | N | N |
| Standards set by FASB | N | N | Y |
| Standards set by FASAB | N | Y | N |
| Standards focused on just the external users of financial information | Y | N | Y |

Ch. 1, Solutions, Exercise 1-20 (Cont’d)

**General Problem Information:** Concepts and reporting characteristics or requirements for governmental and NFP organizations

**Learning Objective:** 1-1

**Learning Objective:** 1-2

**Learning Objective:** 1-4

**Learning Objective:** 1-5

**Topic:** Various chapter topics

**Bloom’s Taxonomy:** Understand

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Medium

* 1. 1. G or F (this will depend on the student; however, generally a public university will be a G and a private university will be an F)

1. FB
2. F
3. G
4. FB
5. F
6. G
7. F
8. G
9. F

**General Problem Information:** Sources of financial reporting standards for various organizations

**Learning Objective:** 1-2

**Topic:** Sources of Financial Reporting Standards

**Bloom’s Taxonomy:** Understand

**Accreditation Skills tag:** AACSB: Communication,AICPA: FN Reporting

**Level of Difficulty:** Medium