Introduction to Accounting and Financial Reporting for Governmental and Not-for-Profit Entities
Learning Objectives

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

2. Identify the authoritative bodies responsible for setting GAAP and financial reporting standards for all governmental and not-for-profit organizations

3. Contrast and compare the objectives of financial reporting for state and local governments, the federal government, and not-for-profit organizations
Learning Objectives

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

5. Identify and describe the required financial statements for the federal government, and not-for-profit organizations
Government & Not-for-Profit Accounting Practices Differ from Business

They have different purposes in society

Management has a special duty to be accountable for how resources are used in providing services

They are financed by resource providers who do not expect benefits proportional to the resources they provide
Types of Governments

General purpose governments provide a broad array of services.

- Federal government, state governments, cities, towns, townships, villages, counties, boroughs, and parishes

Special purpose governments usually provide only a single or just a few services.

- Independent school systems, public colleges and universities, public hospitals, fire protection districts, and many others
Not-for-profit organizations are legally separate organizations which are usually exempt from federal, state, and local taxation.
Characteristics of Government and Not-for-Profit Organizations

Unlike for-profit organizations, resource providers do not expect to receive repayment or proportional benefits.

The organization lacks a profit motive.

There is an absence of transferable ownership rights.
Characteristics of Government Organizations

Power ultimately rests in the hands of the people.
People delegate power to public officials through the election process.
Empowered by and accountable to a higher level government.
The organization has the power to tax.
Sources of GAAP and Financial Reporting Standards

- **FASB**
  - Business organizations
  - Nongovernmental not-for-profits

- **GASB**
  - State and local governmental organizations
  - Governmental not-for-profits

- **FASAB**
  - Federal government and its agencies and departments
“Accountability is the cornerstone of all financial reporting in government… Accountability requires governments to answer to the citizenry—to justify the raising of public resources and the purposes for which they are used.”

-GASB Concepts Statement No. 1
**Interperiod equity** is a government’s obligation to disclose whether current-year revenues were sufficient to pay for current-year benefits—or will future taxpayers be required to pay for them instead?
Objectives of Financial Reporting for State and Local Governments

Governmental financial reports are used primarily to:

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<th>Compare actual financial results with legally adopted budget</th>
<th>Assess financial conditions and results of operations</th>
<th>Assist in determining compliance with finance-related laws, rules and regulations</th>
<th>Assist in evaluating efficiency and effectiveness</th>
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Objectives of Financial Reporting for the Federal Government

Federal government financial reporting should assist report users in evaluating:

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<th>Budgetary integrity</th>
<th>Operating performance</th>
<th>Stewardship</th>
<th>Adequacy of systems and controls</th>
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Objectives of Financial Reporting for Not-for-Profit (NFP) Organizations

NFP financial reporting should provide information useful in:

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<th>Making resource allocation decisions</th>
<th>Assessing services and the ability to provide services</th>
<th>Assessing management stewardship and performance</th>
<th>Assessing economic resources, obligations, net resources, and changes in them</th>
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Minimum Requirements for General Purpose External Financial Reporting

- Management’s discussion and analysis
- Government-wide financial statements
- Fund financial statements
- Notes to the financial statements
- Required supplementary information (other than MD&A)
Government Financial Statements

There are two categories of basic government financial statements:

**Government-wide financial statements**, which provide an aggregated overview of a government’s net position and change in net position and

**Fund financial statements**, which provide more detailed financial information about a government
Government-wide Financial Statements

Assist in assessing *operational accountability*—whether government has used its resources efficiently and effectively in meeting service objectives.

Focus on *flow of economic resources*

Use the *accrual basis of accounting*, like business organizations.
For now, think of a **fund** as a separate set of accounts used to keep track of resources segregated for a particular purpose – more detail on funds is in Chapter 2.
Assist in assessing *fiscal accountability*—whether the government raised and spent financial resources in accordance with budgetary, legal, and regulatory constraints

Focus on *short-term flow of current financial resources*

Use the *modified accrual basis*—revenues recognized when measurable and available for spending; expenditures recognized when an obligation is incurred that will be paid from currently available financial resources
Other fund categories (see Chapter 2):

- **Proprietary funds** report on business-like activities of the government.
- **Fiduciary funds** report on fiduciary (trust and agency) activities of the government.
- Both categories follow accounting principles similar to businesses.
A **Comprehensive Annual Financial Report (CAFR)** provides more detail than the minimum requirements for general purpose financial reporting.

While not required to prepare a CAFR, most governments do so.

CAFR is prepared in conformity with GASB standards.
A CAFR prepared according to GASB standards should contain three sections.

- Introductory Section
- Financial Section
- Statistical Section
CAFR - Introductory Section

- Title page
- Contents page
- Letter of transmittal
- Other (as desired by management)
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. Items included in the financial section are:

- Auditor’s report
- Management’s discussion and analysis (MD&A)
- Basic financial statements (and notes thereto)
- Required supplementary information (RSI)(other than MD&A)
- Combining and individual fund statements and schedules
The statistical section typically presents tables and charts showing demographic and economic data, 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.
Federal financial reporting occurs at two levels:

- U.S. government-wide – prepared by U.S. Treasury
- Major agencies and departments – prepared by major agencies and departments following requirements established in Office of Management and Budget (OMB) Circular A-136
Despite the enormous dollar amounts involved, the U.S. Comptroller General has never been able to issue an audit opinion on the federal government’s consolidated financial statements.

In general, serious financial management and data deficiencies are cited for the Comptroller General’s continuing disclaimer of opinion.
U.S. Government-wide Financial Reporting

The consolidated report includes:

- A “plain language” Citizen’s Guide
- Management’s Discussion and Analysis (MD&A)
- Several financial statements (see Chapter 17)
- Supplemental information reporting on both budgetary and proprietary (operating) financial activities, as well as reconciliation of the two activities
Major federal agencies and departments must 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.
The PAR should include four sections:

1. An MD&A, providing an overview of PAR and a clear description of the department or agency’s mission
2. Performance section containing the APR, which provides information about agency’s performance and progress in achieving its performance goals

4. Other accompanying information such as information about tax burden, tax gap, challenges facing management, and revenue forgone
Not-for-Profit (NFP) Organizations
Financial Reporting

The primary purpose of NFP financial statements is to provide decision-useful financial information to resource providers, such as donors, members, and creditors.

These resource providers need information to assess the services provided by an NFP and the ability of the NFP to continue to provide those services, as well as management’s performance and stewardship of resources.
Those NFP organizations that are nongovernmental in nature are required to follow FASB accounting and financial reporting standards. These standards require presentation of a

- Statement of financial position (balance sheet)
- Statement of activities (income statement)
- Statement of cash flows
In addition to these statements, voluntary health and welfare organizations, such as the YMCA, United Way, and the American Diabetes Association, are required to present a statement of functional expenses. This statement classifies expenses into program and supporting services categories, in addition to traditional line item classifications.
Reporting Requirements Unique to Not for Profit Organizations

- Demonstrating accountability for donor-imposed restrictions by reporting net assets and changes in net assets in the three categories of (1) permanently restricted, (2) temporarily restricted, and (3) unrestricted.

- Reporting program service expenses separately from supporting service expenses. The latter include overhead (such as, non-program management and general expenses) and fund-raising expenses.
Other Accountability Reporting

- Popular Reports – highly condensed and unaudited
- Service Efforts and Accomplishments (SEA) – include both financial and nonfinancial measures of service efforts and service accomplishments
Looking Ahead

Chapters 2 – 9

- Discuss in detail GASB principles, standards and financial reporting, focusing on state and local governments.

Chapters 10, 11 and 12

- Describe ways that public financial managers provide accountability over funds entrusted to them.

Chapters 13 - 17

- Focus on not-for-profit organizations and federal government accounting and reporting.
“...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...”

Professor R. M. Mikesell, 1951