Government and Not-for-Profit Accounting: Concepts and Practices, 7e

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Chapter 1
The Government and Not-for-Profit Environment
Thoughts to Ponder

“We make a living by what we get. We make a life by what we give.”
- Winston Churchill

“Service to others is the rent you pay for your room here on earth.”
- Mohammed Ali

Who, Why & What?

- Who are we?
  - Inspiring future leaders
- Why are we here?
Why study GNP?

- Become familiar with the Public sector
- Government
- Nonprofit
- An Accountability Framework
- Overview of the Governmental Sector: Importance & Size
- US GNP ~ $11,000,000,000,000
- G&NP produce > $5.5,000,000,000,000

Why is state and local government accounting important?

- State and local governments received $1.4 trillion in tax revenues in 2012
  - 8.2% increase over 2007
- Expenditures increased 18.2% to $3.2 trillion from 2007 to 2012.
  - 2012 largest expenditure for state government was public welfare and education were the $433.3 billion and $271.1 billion, respectively
- Total debt outstanding for state and local governments increased 22.2 percent, from $2.4 trillion in 2007 to $2.9 trillion in 2012
- Education, the single largest functional category for all governments, employed 11.0 million people, or 49.8 percent of the total number of federal, state, and local government employees.
Additional Facts

The State of California reported nearly $247.7 billion in revenues from all sources on a GAAP basis in FY2014. California = number 3 on the Fortune 500 as of June 2014, bested only by Wal-Mart Stores, and Exxon – Mobil, to be followed by Chevron, Berkshire Hathaway and Apple

The largest municipal government in America, New York City has over $70 billion in revenues, placing it = number 40 on Fortune 500. Texas is home to 52 of 2014’s Fortune 500 companies. Half of these are based in the Houston area. 9 companies in the 77002 zip code, more than in any other zip code in the country.

The most populous county, Los Angeles, reported about $24.975 billion in revenues in 2013-14, placing it = number 119 on Fortune 500

The City of Houston reported ~$4.4 B in Rev. for FY 2014 placing the city just outside of the Fortune 500.

Total GO debt of the Fed. Govt. has well surpassed $17.55T (April 2014) and if we include MC, MA and SS, it is > $70T (2013)

Learning Objectives

After studying Chapter 1 you should understand

- Characteristics that distinguish governments and not-for-profit organizations from businesses
- Accounting and reporting practices and their implications
- The overall purpose of financial reporting
- The information requirements of the primary users
- Objectives of financial reporting, as established by the GASB, FASB, and FASAB
- How differences in accounting principles affect financial reporting and can have economic consequences
- The institutional arrangements for establishing accounting standards for these entities
How Do Governments and Not-For-Profits Compare with Businesses?

- Different missions
  - Goal of government and not-for-profit is to provide services for the betterment of society
  - Goal of business is to earn profit

- No direct and proportional relationship between resources provided and the benefits received.

- Absence of transferable ownership rights.

- Collective ownership by constituents.

The basic accounting equation

- For profit-based businesses, the accounting equation is as follows:
  \[ \text{Assets} = \text{Liabilities} + \text{Equity} \]

- For governments, the accounting equation is:
  \[ \text{Assets - Liabilities} = \text{Net Position} \] (Equity, aka net assets)

For GNP entities, budget is very important.

- Budget is the culmination of the political process
- The budget is the key fiscal document
- Budgets drive accounting and financial reporting

- Revenues may not be linked to constituent demand or satisfaction
- No direct link between revenues and expenses
- Less distinction between internal and external accounting and reporting.
How Do Governments and Not-For-Profits Compare with Businesses?

- Ensure interperiod equity for most GNPs
  - Interperiod equity – concept that constituents pay for services they receive and not shift burdens to their children

- Resources may be restricted for particular activities or purpose
  - Use fund accounting
  - Example
    - Federal government grants for low-income housing
    - State gasoline tax may be targeted by law at highway construction and maintenance.

How Do Governments and Not-For-Profits Compare with Businesses?

- Power ultimately rests in the hands of the people.
- Citizens vote and delegate that power to elected officials.
- Exercise their sovereign power to collect taxes.
- Created by and accountable to a higher level government.
- Different reporting objectives.
Objectives of Financial Reporting State and Local Governments (SLGs)

- Financial reports are used primarily to:
  - Compare actual results with the budget.
  - Assist in determining compliance.
  - Assist in evaluating efficiency & effectiveness.
  - Assess financial condition and results of operations.

Remember:
- Financial statements are a report of the past; your focus must be on the future.
- One main objective of financial analysis is to derive the economic substance of a transaction from the data provided in the financial statements. Then, it is up to you to recast the data in a form that best facilitates the decisions that you must make.

“ACCOUNTABILITY is the cornerstone of all financial reporting in government,” (GASB Concepts Statement No. 1, par. 56).

Please see the summary of Concepts Statement 1.
- What do we mean by accountability?
- How does “interperiod equity” relate to accountability?
Objectives of Financial Reporting State and Local Governments (SLGs)

What is accountability?
- Accountability arises from the citizens’ “right to know.”
- It imposes a duty on public officials to be accountable to citizens for raising public monies and how they are spent.

Accountability Pyramid
Objectives of Financial Reporting State and Local Governments (SLGs)

- How does “interperiod equity” relate to accountability?
  - Interperiod equity is a government’s obligation to disclose whether current-year revenues were sufficient to pay for current-year benefits—or did current citizens defer payments to future taxpayers?

Objectives of Financial Reporting State and Local Governments (SLGs)

Accountability is also the foundation of Federal government financial reporting

- Federal Accounting Standards Advisory Board (FASAB)’s standards are targeted at both:
  - Internal users (management)
  - External users
Importance of Accounting for SLGs

There are over 90,106 state and local governments in the United States (based on 2012 census)

State and local governments account for:
- 11.7% of U. S. GDP (2012, U.S. Bureau of Economic Analysis)

State and local governments collected approximately $2.54 trillion in general sales and gross tax receipts in 2013.

Composition of the Local U.S. Government Units

Total = 90,056
Composition of the Local U.S. Government Units

- 3,031 Counties
- 19,591 Municipalities
- 16,360 Townships
- 12,880 School districts
- 38,266 Special districts


Importance of the NFP Sector

| TABLE 1-2 | Dimensions of the Not-for-Profit (“Independent”) Sector

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2013 contributions by source $ billion

- Corporations $16.76 billion (5%)
- Bequests $26.81 (6%)
- Foundations $50.28 billion (16%)
- Individuals $241.32 (72%)

2013 contributions by type of recipient organization

- Health 10%
- Education 16%
- Human services 12%
- Religion 31%
- Environment/animals 3%
- Gifts to individuals 1%
- International affairs 5%
- Arts, culture, and humanities 5%
- Public-society benefit 7%
- Gifts to foundations 11%

Total contributions for 2013: $335.17 Billion

Current Highlights
Importance of the NFP Sector

Size and Scope 2012-2014:
- Number of not-for-profit organizations (2014): 1,429,801
- Total nonprofit sector revenues (2013): $1.74 trillion
- Annual contributions from private sources (2013): $335.17 billion
- Percentage of wages and salaries paid in the US (2012): 9.2%

Giving 2013:
- Individuals contribution (72%): $241.32 billion
- Charitable bequests (8%): $26.81 billion
- Foundations (15%): $50.28 billion
- Corporate (5%): $16.76 billion

Impact of the NFP Sector

Volunteering (2013)
- Volunteers contributed an estimated 7.7 billion hours
- Approximately $173 billion worth of work

Overall:
- Contributed an estimated $887.3 billion to the US economy in 2012
- 5.4% of the country’s gross domestic product
Sources of GAAP and Authoritative Bodies

- Authoritative Bodies:
  - FASB – Financial Accounting Standards Board
    - Business organizations: ex. Wal-Mart, Exxon
    - Nongovernmental not-for-profits: New York University
  - GASB – Governmental Accounting Standards Board
    - Governmental entities: ex. New York City, Atlanta, Chicago
    - Governmental not-for-profits: Arizona State University
  - FASAB – Federal Accounting Standards Advisory Board
    - Federal Government and its agencies: ex. Department of Defense,
      • Department of Transportation, Department of Energy,
      • Department of Education, Department of Agriculture,
      • HUD, HHS and others.

Who are the users of financial reports?

- Governing Boards
  - The prime recipients of the report because they approve budgets, major purchases, contracts and significant operating policies.

- Investors and creditors

- Citizens and organizational members

- Donors and Grantors

- Regulatory Agencies

- Employees and other constituents
Several forms of Financial Reporting

- Paper generated text financial statements
- PDF
- Internet- HTML or PDF
- XBRL (eXtensible Business Reporting Language)

Summary

- In this course you will become familiar with current GASB, FASB, and FASAB standards related to governmental and not-for-profit organizations.

- Accounting and reporting for governmental and not-for-profit entities differ from those of for-profit entities because each type of entity has a different mission and reporting objectives.