

---

# **Core Concepts of Government and Not-for-Profit Accounting**

**2nd Edition**

Michael H. Granof

*University of Texas at Austin*

Penelope S. Wardlow, PhD, CGFM



WILEY

JOHN WILEY & SONS, INC.

# CONTENTS

## **CHAPTER 1**

### **The Government And Not-for-Profit Environment 1**

How Do Governments and Not-for-Profits Compare With Businesses? 1

*Different Missions 2*

*Budgets, Not the Marketplace, Govern 2*

*Expenditures May Drive Revenues 2*

*Preeminence of the Budget, Not the Annual Report 2*

*Importance of Budgets in Accounting and Financial Reporting 3*

*Need to Ensure Interperiod Equity 3*

*Revenues Not Indicative of Demand for Goods or Services 3*

*No Direct Link between Revenues and Expenses 3*

*Different Role for Capital Assets 4*

*Resources May Be Restricted 4*

*No Distinct Ownership Interests 5*

*Less Distinction between Internal and External Accounting and Reporting 5*

What Other Characteristics of Governments and Not-for-Profits Have Accounting Implications? 5

*Many Different Types of Governments and Not-for-Profits 5*

*Governments and Not-for-Profits Engage in Business-Type Activities 6*

*Differences between Governments and Not-for-Profits 6*

What Are the Overall Purposes of Financial Reporting? 6

Who Are the Users and What Are the Uses of Financial Reports? 7

*Governing Boards 7*

*Investors and Creditors 7*

*Citizens and Organizational Members 8*

*Donors and Grantors 8*

*Regulatory Agencies 8*

*Employees and Other Constituents 8*

What Are the Specific Objectives of Financial Reporting As Set Forth by the GASB and the FASB? 9

*GASB Objectives 9*

*EXAMPLE Clash Among Reporting Objectives 10*

*GASB Statement No. 34: Two Sets of Financial Statements 11*

*FASB Objectives 11*

*Reporting Service Efforts and Accomplishments Seen as a Long-Term Goal 12*

Do Differences in Accounting Principles Really Matter? 13

*User Adjustments 13*

*Economic Consequences 13*

Who Establishes Generally Accepted Accounting Principles? 14

*The Function of the GASB, the FASB, and the AICPA 14*

*Entities Common to the Government and Not-for-Profit Sectors 14*

Questions for Review and Discussion 16

Exercises and Problems 16

## **CHAPTER 2**

### **Fund Accounting 21**

What Is a Fund? 21

What Characterizes Funds? 21

*Use of Multiple Funds to Account for an Entity 22*

*Basis of Accounting and Measurement Focus 23*

*EXAMPLE: Fund Accounting in a School District 24*

What Are the Main Types of Governments' Funds? 27

What's Notable about Each Type of Governmental Fund? 27

*The General Fund 27*

*Special Revenue Funds 29*

*Debt Service Funds 29*

*Capital Projects Funds 30*

*Permanent Funds 30*

What's Notable about Each Type of Proprietary Fund? 30

*Enterprise Funds 31*

*Internal Service Funds 31*

What's Notable about Each Type of Fiduciary Fund? 32

*Trust Funds 32*

*Agency Funds 32*

How Do the Funds of Not-for-Profits Differ from Those of Governments? 33

Questions for Review and Discussion 33

Exercises and Problems 34

## **CHAPTER 3**

### **Government Financial Reporting 39**

How Can Funds Be Combined and Consolidated? 39

What Is GASB Statement No. 34? 40	<i>Types of Intergovernmental Revenues</i> 75
<i>Fiscal versus Operational Accountability</i> 40	<i>Private Contributions</i> 76
What Are the Required Basic Financial Statements? 41	<i>Examples of Accounting for Grants and Contributions</i> 76
What Are the Government-Wide Financial Statements? 42	<i>EXAMPLE Unrestricted Grant with Time Requirement</i> 76
<i>Government-Wide Statement of Net Assets</i> 42	<i>EXAMPLE Grant with Purpose Restriction</i> 77
<i>Importance of Restrictions on Net Assets</i> 43	<i>EXAMPLE Reimbursement (Eligibility Requirement) Grant</i> 77
<i>Government-Wide Statement of Activities</i> 43	<i>EXAMPLE Unrestricted Grant with Contingency Eligibility Requirement</i> 78
<i>Calculating the Net Cost to Taxpayers</i> 45	<i>EXAMPLE Endowment Gift</i> 78
What Are the Fund Financial Statements? 46	<i>EXAMPLE Pledges</i> 78
<i>Governmental Funds</i> 46	<i>Accounting for Pass-Through Grants</i> 78
<i>Proprietary Funds</i> 50	How Should Sales of General Capital Assets Be Accounted for? 79
<i>Fiduciary Funds</i> 52	<i>EXAMPLE Sales of General Capital Assets</i> 79
What Are Notes and Required Supplementary Information? 57	How Should Investment Gains and Losses Be Accounted for? 80
<i>Budgetary Comparisons</i> 57	<i>EXAMPLE Investment Income</i> 81
What Additional Information Do Governments Typically Report? 59	How Should External Investment Pools Be Accounted for? 82
Questions for Review and Discussion 59	How Should Interest on Investments Be Accounted for? 82
Exercises and Problems 59	<i>EXAMPLE Interest Income on a Discounted Note</i> 82
<b>CHAPTER 4</b>	How Should Licenses, Permits, and Other Exchange or “Exchange-Like” Transactions Be Accounted for? 83
<b>Governmental Activities—Revenues 64</b>	<i>EXAMPLE License Fees</i> 83
Why and How Do Governments Use the Modified Accrual Basis of Accounting? 64	How Should Governments Report Revenues in Their Government-Wide Statements? 84
<i>Rationale for the Modified Accrual Basis</i> 64	Questions for Review and Discussion 86
<i>Relationship between Measurement Focus and Basis of Accounting</i> 65	Exercises and Problems 86
<i>Overview of the Modified Accrual Basis</i> 65	
What Triggers Revenue Recognition for Nonexchange versus Exchange Transactions? 66	<b>CHAPTER 5</b>
<i>Statement No. 33</i> 66	<b>Governmental Activities—Expenditures And Expenses 92</b>
<i>Meaning and Rationale for “Available to Finance Expenditures of the Current Period”</i> 66	How Is the Accrual Concept Modified for Exchange Expenditures? 92
What Are the Main Types of Nonexchange Revenues? 67	<i>The Distinction between Expenditures and Expenses</i> 92
How Should Property Taxes and Other Imposed Nonexchange Revenues Be Accounted for? 68	<i>Modifications to the Accrual Basis</i> 93
<i>Significant Events in the Revenue Generation Process</i> 69	How Should Wages and Salaries Be Accounted for? 93
<i>Examples</i> 69	<i>EXAMPLE: Wages and Salaries</i> 93
<i>EXAMPLE Property Taxes</i> 69	How Should Compensated Absences Be Accounted for? 94
<i>Delinquent Property Taxes</i> 71	<i>Accounting for Vacations</i> 94
<i>Property-Tax Write Offs</i> 71	<i>EXAMPLE: Vacation Leave</i> 95
<i>Other Imposed Nonexchange Revenues</i> 72	<i>Accounting for Sick Leave</i> 96
How Should Sales and Income Taxes and Other Derived Tax Revenues Be Accounted for? 72	<i>EXAMPLE: Sick Leave</i> 96
<i>Significant Dates for Sales Taxes</i> 73	How Should Pensions and Other Postemployment Benefits Be Accounted for? 97
<i>EXAMPLE Sales Taxes</i> 73	<i>EXAMPLE: Pension Contributions</i> 97
<i>Income Taxes—the Collection Process</i> 74	
<i>EXAMPLE Income Taxes</i> 75	
How Should Grants and Similar Nonexchange Revenues Be Accounted for? 75	

- How Should Claims and Judgments Be Accounted for? 98  
*EXAMPLE: Claims and Judgments* 98
- How Should the Acquisition and Use of Materials and Supplies Be Accounted for? 99  
*EXAMPLE: Supplies* 100  
*Purchases Method* 100  
*Consumption Method* 101
- How Should Prepayments Be Accounted for? 101
- How Should Capital Assets Be Accounted for? 102  
*EXAMPLE: Capital Assets* 102  
*EXAMPLE: Installment Notes* 103
- How Should Interest and Principal on Long-Term Debt Be Accounted for? 104  
*EXAMPLE: Long-Term Debt* 104  
*Adverse Consequences of Focus on Cash Payments* 105  
*Accrual of Interest and Principal When Resources Are Transferred* 105
- How Should Nonexchange Expenditures Be Accounted for? 106
- How Should Interfund Activities Be Accounted for? 107  
*EXAMPLE: Interfund Transfer* 107  
*EXAMPLE: Interfund Purchase/Sale* 107
- What Constitute Other Financing Sources and Uses? 109
- How Should Governmental Fund Operating Statements Be Reported? 109
- What Is the Significance of the Governmental Fund Financial Statements?—An Overview 110
- Questions for Review and Discussion 112
- Exercises and Problems 112
- CHAPTER 6**  
**Governmental Activities—Capital Projects and Debt Service 119**
- How Do Governments Account for Capital Projects? 119  
*Reasons for Maintaining Capital Projects Funds* 119  
*Basis of Accounting* 120  
*Fund Financial Statements* 120  
*Reporting Bond Proceeds and Issue Costs* 120  
*EXAMPLE: Bond Premiums and Discounts* 121
- COMPREHENSIVE EXAMPLE: *Main Types of Transactions Accounted for in Capital Projects Funds* 122
- How Do Governments Account for Resources Dedicated to Debt Service? 125  
*Reasons for Maintaining Debt Service Funds* 125  
*Basis of Accounting* 125
- COMPREHENSIVE EXAMPLE: *Main Types of Transactions Accounted for in Debt Service Funds* 126
- How Do Governments Handle Special Assessments? 129  
*Reasons for Special Assessments* 129  
*Accounting for Special Assessment Capital Projects and the Related Debt* 129  
*Government Obligations As to Property-Owners' Debt* 130  
*Accounting for Special Assessments in Enterprise Funds* 131
- Why Is Arbitrage a Concern of Governments? 132  
*Complexity of Federal Regulations* 132  
*Accounting Problems* 133
- How Can Governments Benefit from Debt Refundings? 133  
*General Rule As to Potential for Economic Gains* 133  
*EXAMPLE: Debt Refundings* 133
- Realizing Economic Gains—Exceptions to the General Rule 134  
*EXAMPLE: In-Substance Defeasance* 135  
*Recognizing the Gain or Loss in Proprietary Funds and in Government-Wide Statements* 136
- Questions for Review and Discussion 137
- Exercises and Problems 138
- CHAPTER 7**  
**Governmental Activities—Capital Assets and Investments in Marketable Securities 144**
- What Accounting Practices Do Governments Follow for General Capital Assets? 145  
*Maintaining Accounting Control over Capital Assets* 145  
*Placing a Value on General Capital Assets* 146  
*How Should Governments Account for Collectibles?* 147
- Why and How Should Governments Report Infrastructure? 148  
*The Modified Approach Compared with Standard Depreciation* 149  
*Retroactive Capitalization of Existing Infrastructure* 151  
*A Controversial Pronouncement* 151  
*Deferred Maintenance* 152
- What Are the Limitations of Information Reported about General Capital Assets? 152
- How Should Governments Account for Assets that Are Impaired? 153
- What Issues Are Critical As to Investments in Marketable Securities and Other Financial Instruments? 154  
*Reasons for Purchasing Marketable Securities* 154  
*Causes for Special Concern* 155  
*Special Risks of Repurchase Agreements* 155

*Sunshine As the Best Means to Promote Sound Investment Practices* 156  
*Special Risks of Derivatives* 157  
 Questions for Review and Discussion 158  
 Exercises and Problems 158

**CHAPTER 8**

**Governmental Activities—Long-Term Obligations 164**

Why Is Information on Long-Term Debt Important to Statement Users? 164  
 Can Governments Go Bankrupt? 165  
 How Do Governments Account for General Long-Term Obligations? 166  
*Accounting for Long-term Obligations in Governmental Funds* 166  
*EXAMPLE: Accounting for Bonds in Government-Wide Statements* 168  
 What Constitutes Long-Term Debt of Governmental Activities? 168  
*Term versus Serial Bonds* 168  
*Demand Bonds: Current or Long-Term Liabilities?* 169  
*Bond Anticipation Notes* 170  
*Tax Anticipation and Revenue Anticipation Notes* 170  
*Operating Leases* 171  
*Capital Leases* 172  
*EXAMPLE: Capital Leases* 174  
*Links between Revenue Bonds and General Obligation Bonds* 175  
*Overlapping Debt* 176  
*EXAMPLE: Overlapping Debt* 176  
*Conduit Debt* 178  
 What Other Information Do Users Want to Know about Outstanding Debt? 178  
*Credit Enhancements* 179  
*Debt Margin* 179  
*Payout Schedules* 180  
*Reserve Funds* 180  
*Common Ratios and Past History* 180  
 What Are Bond Ratings and Why Are They Important? 181  
 Questions for Review and Discussion 182  
 Exercises and Problems 182

**CHAPTER 9**

**Business-Type Activities and Internal Services 188**

Why Do Governments Engage in Business-Type Activities? 188  
 What Are Proprietary Funds? 189

Should Governments Account for Proprietary Funds Differently than Governmental Funds? 190  
 What Are the Three Basic Financial Statements of Proprietary Funds? 191  
*Statement of Net Assets (or Balance Sheet)* 191  
*Statement of Revenues, Expenses, and Changes in Fund Net Assets (Income Statement)* 194  
*Statement of Cash Flows* 194  
 What Accounting Issues Are Unique to Enterprise Funds? 196  
*Criteria for Establishing an Enterprise Fund* 196  
*Accounting Standards* 196  
*Budgets* 197  
*Capital Contributions* 197  
*Environmental Issues* 198  
*EXAMPLE: Landfill Costs in an Enterprise Fund* 200  
 What Are Internal Service Funds, and How Are They Accounted for? 202  
*Reasons for Establishing Internal Service Funds* 203  
*Revenue and Expense Recognition* 203  
*EXAMPLE: Internal Service Fund Accounting* 203  
*Basis for Establishing Billing Rates* 204  
*Ramifications for Other Funds* 205  
 What Special Problems Are Created in Accounting for Self-Insurance? 206  
*Using an Internal Service Fund* 207  
*EXAMPLE: Insurance Premiums* 208  
*Using the General Fund* 208  
*EXAMPLE: Self-Insurance in a General Fund* 208  
 How Are Proprietary Funds Reported? 209  
*Enterprise Funds: Government-Wide Statements* 209  
*Enterprise Funds: Fund Statements* 210  
*Internal Service Funds: Government-Wide Statements* 210  
*EXAMPLE: Eliminating Interfund Balances and Transactions of Internal Service Funds* 211  
*Internal Service Funds: Fund Statements* 212  
 What Do Users Want to Know about Revenue Debt? 212  
 Questions for Review and Discussion 214  
 Exercises and Problems 214

**CHAPTER 10**

**Permanent Funds And Fiduciary Funds 222**

What Are Endowments? 223  
 What Are Permanent Funds and How Are They Distinguished from Fiduciary Funds? 223

- Permanent Funds* 223  
*Fiduciary Funds* 223
- Why Should All Endowments Be Accounted for on a Full Accrual Basis—and Why Aren't They? 224  
*EXAMPLE: Charging Depreciation* 224
- Should Investment Gains Be Considered Net Additions to Endowment Principal or Expendable Income? 226  
*EXAMPLE: Investment Gains of an Endowment* 226
- How Should Permanent Fund Investment Losses Be Accounted for? 227  
*EXAMPLE: Investment Losses of a Permanent Fund* 227
- How Are Endowment Transactions Recorded and Reported? 228  
*Permanent Fund* 228  
*EXAMPLE: Recording Transactions in a Permanent Fund* 228  
*Private Purpose Trust Fund* 231
- What Financial Statements Are Required for Fiduciary Funds? 232
- What Are Pensions and Why Are They Important? 233
- How Should an Employer Account for its Pension Contributions? 233  
*Defined Contribution versus Defined Benefit Plans* 233  
*Calculating the Annual Required Contribution* 234  
*Accounting Issues* 234  
*EXAMPLE: Pension Contributions* 235  
*Limitations* 236
- How Should a Defined Benefit Pension Plan Be Accounted for? 236  
*Statement of Plan Net Assets* 237  
*Statement of Changes in Plan Net Assets* 237  
*Required Schedules* 238
- How Should Postemployment Benefits Other Than Pensions (OPEB) Be Accounted for? 240  
*Accounting by Employers* 241  
*Accounting for the OPEB Plan* 241  
*Effects of the New Standards* 241
- What Accounting Issues Do Investment Trust Funds Present? 242
- What Accounting Issues Do Agency Funds Present? 242  
*Establishing Agency Funds* 243
- Questions for Review and Discussion 244  
 Exercises and Problems 244
- CHAPTER 11**  
**Issues of Reporting and Disclosure** 252
- How Can a Government Prepare Government-Wide Statements from Fund Statements? 252
- Why Is the Reporting Entity an Issue for Governments? 254  
*EXAMPLE: The Reporting Entity* 254
- What Criteria Have Been Established for Government Reporting Entities? 255  
*Types of Units Composing the Reporting Entity* 255  
*Meaning of Financially Accountable Component Units* 256  
*EXAMPLE: Financially Accountable Component Units* 256  
*Fiscal Dependency* 256  
*Reporting Component Units* 257  
*Reporting Other Types of Units* 258  
*EXAMPLE: Summary of Statement No. 14* 259  
*Controversy Surrounding Statement No. 14* 260
- What Is Included in a Government's CAFR? 260  
*Introductory Section* 261  
*Financial Section* 261  
*Statistical Section* 264
- What Are the Reporting Requirements for Colleges, Universities, and Other Special-Purpose Governments? 265  
*General Requirements* 266  
*Requirements for Colleges and Universities* 266  
*Segment Information* 267
- Questions for Review and Discussion 271  
 Exercises and Problems 272
- CHAPTER 12**  
**Not-for-Profit Organizations** 279
- Who's in Charge? 279
- What Should the Form and Content of Financial Statements Be? 280  
*Reporting Assets and Liabilities* 280  
*Reporting Revenues and Expenses* 281  
*EXAMPLE: Reporting Revenues and Expenses* 283  
*Reporting Cash Flows* 285
- What Are Contributions, and How Should Pledges Be Accounted for? 289  
*Contributions versus Exchange Transactions* 289  
*Pledges* 289  
*EXAMPLE: Pledges* 290
- When Should Use-Restricted Contributions Be Recognized? 292  
*EXAMPLE: Use-Restricted Contributions* 292
- Should Contributions of Services Be Recognized? 293  
*EXAMPLE: Service Contributions* 294
- Should Contributions of Collection Items Be Recognized As Revenues? 294
- When Should Conditional Promises Be Recognized? 295  
*EXAMPLE: Conditional Promises* 295

How Should “Pass-Through” Contributions Be Accounted for? 296  
*EXAMPLE: A Federated Fund-Raising Organization* 296  
*EXAMPLE: A Foundation that Transfers Assets to a Specified Organization* 297  
*EXAMPLE: A Foundation that Supports a Related Organization* 297

When Should Gains and Losses on Investments Be Recognized? 298  
*EXAMPLE: Investment Gains* 299

How Should Organizations Account for Gains and Losses on Endowments? 300  
*Endowment Gains* 300  
*Endowment Losses* 300

How Should Depreciation Be Reported? 301  
*EXAMPLE: Depreciation* 301

What Issues Does a Not-for-Profit Face in Establishing Its Reporting Entity? 302  
*Mergers and Acquisitions* 303

COMPREHENSIVE EXAMPLE: *Museum of American Culture* 304

Questions for Review and Discussion 311  
 Exercises and Problems 312

**CHAPTER 13**

**Special Issues for Not-for-Profit Health Care Providers and Institutions of Higher Education 319**

What Unique Issues Do Health Care Providers Face? 320  
*Differences between Not-for-Profit and Government Health Care Providers* 320  
*Financial Statements and Fund Structure* 321  
*Classification of Revenues and Expenses* 322  
*Recognizing Fee-for-Service Patient-Care Revenues* 322  
*EXAMPLE: Patient-Care Revenues* 323  
*Recognizing Capitation Fee Revenues* 324  
*EXAMPLE: Capitation Fee Revenues* 324  
*Accounting for and Reporting Charity Care* 325  
*EXAMPLE: Charity Care* 325  
*Accounting for and Reporting Malpractice Contingencies* 325  
*EXAMPLE: Malpractice Claims* 326  
*Reporting Retrospective Insurance Premiums* 326  
*EXAMPLE: Retrospective Premiums* 327

What Unique Issues Do Colleges and Universities Face? 327  
*Classification of Revenues and Expenses* 328  
*Recognizing Tuition and Fee Revenues and Related Expenses* 330  
*EXAMPLE: Tuition and Fee Revenues* 330  
*Accounting for and Reporting Grants* 331

*EXAMPLE: Grants* 332  
 Questions for Review and Discussion 335  
 Exercises and Problems 335

**CHAPTER 14**

**Auditing Governments and Not-for-Profit Organizations 344**

How Do Audits of Governments and Not-for-Profits Differ from Those of Businesses? 345  
 How Has the Yellow Book Influenced Government and Not-for-Profit Auditing? 345  
 What Types of Audits Do Governments Conduct? 346  
 What Levels of Standards Are Applicable to All Engagements? 346  
 What Are the Key Differences between Government and Nongovernment Financial Audit Standards? 351  
*General Standards* 351  
*Standards of Field Work* 353  
*Standards of Reporting* 353

How Have the Single Audit Act and Other Pronouncements Influenced Auditing? 354  
 What Approach Do Auditors Take in Performing Single Audits? 355  
*Identifying Major Programs: A Risk-Based Approach* 356  
*Key Procedures* 356

What Reports Result from Single Audits? 359  
*Opinion on the Financial Statements and on the Schedule of Expenditures of Federal Awards* 359  
*Report on Compliance and on Internal Control over Financial Reporting* 359  
*Report on Compliance with Requirements of Major Programs* 360  
*Schedule of Findings and Questioned Costs* 360

What Are Performance Audits? 361  
*Key Differences between Financial and Performance Audits* 361  
*Manner of Conducting* 363  
*EXAMPLE: Evidence Gathering* 366  
*How Sarbanes-Oxley and IRS Regulations Are Affecting Governments and Not-for-Profits* 368

What Unique Ethical Issues Do Government and Not-for-Profit Accounting and Auditing Present? 368  
*Determining Right from Wrong* 369  
*Characteristics of Governments that Justify a Unique Perspective on Ethical Questions* 369  
*Analyzing Ethical Dilemmas* 370  
*EXAMPLE: Ethical Dilemma* 371

Questions for Review and Discussion 372  
 Exercises and Problems 373

**CHAPTER 15****Financial Analysis 381**

How Can a Government's Economic Condition Be Assessed? 381

*The CAFR Is an Important, But Not Exclusive,*

*Source of Information 384*

*Evaluating Fiscal Capacity 385*

Why Is It Important to Assess Likely Future Changes? 386

*Population 386*

*Enterprises 386*

*Technology 387*

Why Is It Important to Evaluate Accounting and Reporting Practices? 387

*The Budget 387*

*The Financial Statements 387*

What Ratios and Other Indicators May Be Useful? 388

*Fiscal Effort 388*

*Operating Deficits 389*

*Analyzing Revenue and Expenditure Trends 389*

*Assessing the Balance Sheet (or Statement of Net Assets) 391*

How Can a Not-for-Profit's Economic Condition Be Assessed? 392

*Identifying Key Factors 392*

*Analyzing Revenues and Expenses 395*

*Analyzing Operational Efficiency and Effectiveness 396*

How Can Conclusions Be Drawn? 397

Questions for Review and Discussion 397

Exercises and Problems 398

**Glossary 404**

**Index 419**