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Article

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European Financial and Accounting Journal

Provided in Cooperation with:

Faculty of Finance and Accounting, Prague University of Economics and Business

Suggested Citation: Ištvánfyová, Jana; Mejzlík, Ladislav (2010) : Accounting Standards for the Public and Non-profit Organization in the USA, European Financial and Accounting Journal, ISSN 1805-4846, University of Economics, Faculty of Finance and Accounting, Prague, Vol. 5, Iss. 2, pp. 71-81,
<https://doi.org/10.18267/j.efaj.50>

This Version is available at:

<https://hdl.handle.net/10419/109848>

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Accounting Standards for the Public and Non-profit Organization in the USA[#]

*Jana IŠTVÁNFYOVÁ** – *Ladislav MEJZLÍK***

Introduction

Governmental accounting is a specialized area that has undergone significant changes over the past few decades. As governmental accounting standards have developed, the complexities of preparing financial statements for governmental entities have greatly increased. Providing meaningful financial information to a wide range of users is not an easy task. Adding to these challenges, the Governmental Accounting Standards Board (GASB) recently introduced sweeping changes to the governmental financial reporting model.

Currently, governmental accounting standards are established by the GASB. The GASB is a “sister” organization to the Financial Accounting Standards Board (FASB). The FASB establishes accounting standards for private sector entities, including both commercial entities and not-for-profit organizations.

Prior to the formation of the GASB, governmental accounting standards were promulgated by the National Council on Governmental Accounting (NCGA). The first of several collections of municipal accounting standards issued by the NCGA in 1934 became known as the “blue book.” Currently, the focus of the blue book is to provide financial statement preparers (and their auditors) with detailed and practical guidance to implement authoritative accounting standards.

[#] This article was prepared as a result of the research plan *Development of Financial and Accounting Theory and its Application in Practice from Interdisciplinary Point of View* (registered number MSMT6138439903).

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This article discusses the following topics related to the background on the development and purpose of governmental accounting standards:

1. Entities covered by governmental accounting principles;
2. Objectives of governmental accounting and financial reporting;
3. Hierarchy of governmental accounting standards.

The field of governmental accounting and auditing has undergone tremendous growth and development over the last twenty-five years. Generally accepted accounting principles for governments were once a loosely defined set of guidelines followed by some governments and governmental entities, but now have developed into highly specialized standards used in financial reporting by an increasing number of these entities. Because of this standardization, users are able to place additional reliance on these entities' financial statements.

The GASB has completed its new model for financial reporting by governments that results in a radically different look to governmental financial statements from those of the past. There have also been substantive changes in the accounting principles used by governments. Governmental financial statement preparers, auditors, and users must have a complete understanding of these requirements to fulfill their financial reporting obligations.

1 Entities covered by governmental accounting principles

In general, the following entities are covered by governmental generally accepted accounting principles:

- State governments;
- Local governments such as cities, towns, counties, and villages;
- Public authorities such as housing finance, water, and airport authorities;
- Governmental colleges and universities;
- School districts;
- Public employee retirement systems;
- Public hospitals and other health care providers.

Governments covered by governmental accounting principles are sometimes distinguished as general-purpose governments (which include

states, cities, towns, counties, and villages) and special-purpose governments (which is a term used in GASBS 34 to refer to governments and governmental entities other than general-purpose governments). Both general-purpose and special-purpose governments are covered by governmental generally accepted accounting principles.

Not-for-profit organizations are not included within the scope of governmental accounting standards unless they are considered governmental not-for-profit organizations, nor are the federal government and its various agencies and departments. Not-for-profit organizations and the federal government are sometimes confused with the governments that this book is addressing when they are homogenized into something commonly referred to as the “public sector.” Not all public-sector entities are subject to governmental accounting principles and standards (Granof – Wardlow, 2003).

A definition of a governmental not-for-profit organization (subject to the accounting standards promulgated by the GASB) is found in the AICPA Audit and Accounting Guide Not-for-Profit Organizations (the Guide). The Guide defines governmental organizations as “public corporations and bodies corporate and politic.” Other organizations are governmental organizations under the Guide’s definition if they have one or more of the following characteristics:

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

The following are examples of “public corporations” that are often found at the state and local government level (Ruppel, 2008). These organizations would usually be considered governmental entities when the definition provided in the Guide is applied.

- Public hospital;
- Economic developed corporation;
- Housing authority;
- Water and sewer utility;

- Electric or gas utility;
- Off-track betting corporation;
- Industrial development authority;
- Educational construction authorities.

Typically, these organizations are created by acts of state legislatures. Their continued existence and legal authority to operate can generally be changed at the discretion of the state legislature.

GASBS 34 eliminated some of the apparent inconsistencies that existed in the past about financial reporting for governmental not-for-profit organizations. Prior to implementation of GASBS 34, these organizations were permitted to follow the AICPA financial reporting model for not-for-profit organizations, although they were subject to the disclosure requirements contained in GASB Statements. In the author's experience, these entities' financial statements often contained many inconsistencies in presentation and omissions of required disclosures. Under GASBS 34, the accounting and financial reporting for these organizations should be clear. They are special-purpose governments that should follow the accounting guidance as delineated under GASBS 34 and should follow all applicable GASB disclosure requirements.

The implementation of GASBS 39 results in more not-for-profit organizations being included within the financial reporting entity of a government or governmental entity. In these cases, GASBS 39 does not require that these not-for-profit organizations comply with the financial reporting requirements for governments. Despite their inclusion within a government's reporting entity, many of these types of organizations (such as fund-raising foundations) would not be considered governmental organizations and would still report their separately issued financial statements using the standards of the Financial Accounting Standards Board (FASB). The financial statement preparer should incorporate the not-for-profit organization's financial statements (reported using FASB principles) within the governmental reporting model (using GASB principles) which may require that the not-for-profit organization actually be reported somewhat separately from the primary government, such as on a separate page. Appendix E of GASBS 39 provides an illustration of including a not-for-profit organization foundation with a governmental university.

2 Objectives of governmental accounting and financial reporting

The need for separate accounting and financial reporting standards for governments depends on the identities of the groups of readers and users of the financial statements of state and local governments, the objectives of these readers and users, and the overall objectives of governmental financial reporting (IFAC, 2005).

In 1987, the GASB issued Concepts Statement 1, Objectives of Financial Reporting (GASBCS 1), which identifies the primary users of the financial statements of state and local governments and their main objectives. To determine the objectives of governmental financial reporting, the GASB first set forth the following significant characteristics of the governmental environment (Larkin – DiTommaso, 2006):

- Primary characteristics of a government's structure and the services it provides;
- Control characteristics resulting from a government's structure;
- Use of fund accounting for control purposes;
- Dissimilarities between similarly designated governments;
- Significant investment in non-revenue-producing capital assets;
- Nature of the political process;
- Users of financial reporting;
- Uses of financial reporting;
- Business-type activities.

GASBCS 1 describes accountability as the “cornerstone” of all financial reporting in governments. Accountability requires that governments answer to the citizenry in order to justify the raising of public resources and the purposes for those resources. Accountability is based on the general belief that the citizenry has a right to know financial information and a right to receive openly declared facts that may lead to public debate by the citizens and their elected representatives.

Interperiod equity is the concept underlying many of the balanced budget legal requirements found in governments, which intend that the current generation of citizens should not be able to shift the burden of paying for current-year services to future-year taxpayers. GASBCS 1 states that interperiod equity is a significant part of accountability and is

fundamental to public administration. As such, it needs to be considered when establishing financial reporting objectives. Financial reporting should help users assess whether current-year revenues are sufficient to pay for the services provided that year and whether future taxpayers will be required to assume burdens for services previously provided.

Tab. 1: Characteristics of effective financial reporting.

Understandable	Governmental financial reporting should be expressed as simply as possible so that financial reports can be understood by those who may not have detailed knowledge of accounting principles. This does not mean, however, that information should be excluded from financial reports merely because it is difficult to understand.
Reliable	The information presented in financial reports should be verifiable, free from bias, and should faithfully represent what it purports to represent. This requires that financial reporting be comprehensive; for instance, nothing significant or material is left out from the information to faithfully represent the underlying events and conditions. Reliability is affected by the amount of estimation in the measurement process and by uncertainties inherent in the item being measured. To this end, financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in the process.
Relevant	Relevancy implies that there is a close logical connection between the information provided in financial reporting and its purpose. Information should be considered relevant if it can make a difference in a user's assessment of a problem, condition, or event.
Timely	If financial reports are to be useful, they must be issued soon enough after the reported events to affect decisions. Timeliness in some circumstances may be so essential that it may be worth sacrificing some degree of precision or detail in the information presented.

Consistent	Presumably, once an accounting principle or reporting method is adopted, it will be used for all similar transactions and events. Consistency should extend to all areas of financial reporting, including valuation methods, basis of accounting, and determination of the financial reporting entity.
Comparable	Financial reporting should facilitate comparisons between governments, such as comparing costs of specific functions or components of revenue. Comparability implies that differences between financial reports should be due to substantive differences in the underlying transactions or the governmental structure, rather than selection among different alternatives in accounting procedures or practices.

Objectives of Financial Reporting

With all of the above factors taken into consideration, GASBCS 1 describes what the GASB set forth as the financial reporting objectives for governments. All of the financial reporting objectives listed and described below flow from what the GASB believes to be the most important objective of financial reporting for governments: accountability. The GASB concluded that the same objectives apply to governmental-type activities as to business-type activities, since the business-type activities are really part of the government and are publicly accountable (Tierney, 2007).

At a time when the GASB is significantly changing the financial reporting model of governments, it is important to understand and keep in mind the underlying objectives of governmental financial reporting described in GASBCS 1.

The preparer or auditor of a governmental entity's financial statements must also understand these objectives as part of the framework used to determine the appropriate accounting treatment for the many types of transactions that fall within a "gray" area. Many times, the precise accounting treatment for a particular transaction or type of transaction is unclear from the promulgated standards. Understanding the financial reporting objectives and the conceptual framework with which these objectives were developed provides additional input in attempting

to record these types of gray-area transactions within the spirit and intent of the promulgated accounting standards.

3 Hierarchy of governmental accounting standards

The GASB is responsible for promulgating accounting principles for governments. The manner in which the GASB promulgates accounting principles depends somewhat on the pervasiveness and the degree of impact that a new accounting principle is anticipated to have. Generally, an issue or topic will be brought to the GASB's attention for consideration from any of a number of sources, including governments themselves, independent auditors, the GASB board members, or GASB staff. In addition, advisory committees, such as the Governmental Accounting Standards Advisory Council, may also bring matters to the GASB's attention for consideration. Based on the input of these individuals, organizations, and groups regarding important technical issues that need to be addressed, the GASB will determine its formal technical agenda. Once a matter is placed on the GASB's technical agenda, staff resources are devoted to the issue to study and evaluate various alternatives to address it. After the initial research is completed, the GASB staff may issue an Invitation to Comment (ITC) or a Discussion Memorandum (DM) to solicit comments from the constituent groups regarding the advantages and disadvantages of the various alternatives available. Upon receipt and analysis of the feedback from an ITC or a DM, the GASB may be able to reach some initial conclusions about the contents of a final accounting standard. If this is the case, the GASB will issue an Exposure Draft (ED) for public comment. If the GASB still has remaining questions or feels that additional feedback is needed from the constituent community, it may issue a Preliminary Views document (PV). The PV sets forth preliminary views on an accounting matter, but also poses additional questions to the constituent community with the hope of soliciting additional input to be included in the next stage in the due process procedure, the ED.

For issues that are not very pervasive or complex, or where the alternatives are limited, the GASB will decide not to issue an ITC or a DM and move directly to issue an ED. This is the most frequently used approach. ITCs and DMs are reserved for the more important and complex issues.

The GASB evaluates and considers the feedback obtained from an ED and then issues a final Statement. If significant changes result from the feedback obtained from the ED, the GASB may choose to issue a second ED before it proceeds to the final Statement.

The process described above would apply whether the GASB is issuing a new Statement or an Interpretation of an existing Statement. In addition to Statements and Interpretations, the GASB issues Technical Bulletins (TBs) and Implementation Guides (usually called “Q&As” because of their question-and-answer format). These two documents are not subject to the same due process procedures described above for new Statements and Interpretations. TBs and Q&As are actually issued by the GASB staff, but they may not be issued if, after review, a majority of the GASB board objects to their issuance.

GAAP Hierarchy for Governments

The levels of authority of the various types of established accounting principles and other accounting literature for governments was actually clarified by the American Institute of Certified Public Accountants (AICPA). The AICPA issued Statement on Auditing Standards 69, The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles” in the Independent Auditor’s Report (SAS 69). The purpose of SAS 69 was to define the framework of generally accepted accounting principles that an auditor should use to judge whether financial statements are presented fairly within that framework. SAS 69 divides established accounting principles and other accounting literature into two main categories: other-than-governmental entities and governmental entities. Within each category, established accounting principles are divided into four categories (or levels), A through D, with Category A being the highest level of authority.

Tab. 2: Hierarchy of generally accepted accounting principles for governmental entities:

Level A	Officially established accounting principles consist of GASB Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to state and local governmental entities by GASB Statements or Interpretations.
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Level B	GASB Technical Bulletins and, if specifically made applicable to state and local governmental entities by the AICPA and cleared by the GASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.
Level C	AICPA AcSEC Practice Bulletins, if specifically made applicable to state and local governmental entities and cleared by the GASB, as well as consensus positions of a group of accountants organized by the GASB that attempts to reach consensus positions on accounting issues applicable to state and local governmental entities. (This group, which would function as an Emerging Issues Task Force, has not been organized by the GASB.)
Level D	Level D includes Implementation Guides (Q&As) published by the GASB staff and practices that are widely recognized and prevalent in state and local governments.

Conclusion

Governmental accounting is complex and specialized area of accounting. This article was intended to be an introduction to the basic issues and concepts. Governmental accounting is a dynamic and constantly evolving discipline and extensive guidance is available to further research any specific governmental accounting issues.

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ABSTRACT

Governmental accounting in the US has undergone significant changes and with it the complexities of preparing financial statements for governmental entities increased. The GASB, Governmental Accounting Standards Board establishes the rules for reporting financial information for non-profit and public entities. The most important objective of governmental accounting and financial reporting is accountability. The GAAP hierarchy for governments consists of four levels, each having a varied degree of authority.

Key words: Governmental accounting standards board; GASB; Financial reporting; Not-for-profit organizations; Public sector; GAAP.

JEL classification: M40.