
UNIT 1: OVERVIEW OF GOVERNMENT ACCOUNTING

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1.0 AIMS AND OBJECTIVES

This unit aims at explaining the concept of fund accounting and organizations using. This accounting system.

After going through this unit, you will be able to:

- 📖 understand classification of not for profit organizations
- 📖 explain those organizations using fund accounting system
- 📖 compare and contrast accounting for profitable and non-profitable organizations
- 📖 identify government financial reporting.

1.1 INTRODUCTION

There are organizations whose object is not to make profit. these not-for-profit organizations account their resources and financial activities under different accounting system. Every organization wants to be successful. Of course. In order to know if it is successful, “success” must be defined in terms of goals. And then it needs some means to

measure its results against its goals. Measuring success is often thought of in terms of effectiveness (achieving the goal at the highest level) and efficiency (achieving the goal through using the least amount of resources. for profit seeking organizations(F.P.) or

organizations whose objective is to make profit, both efficiency and effectiveness can easily be measured with financial statement. There are certainly non financial criteria to judge success like qualitative or quantitative measures. But regardless of what other measures are employed, ultimately effectiveness will be measured by the income statement. Not only income statement measures effectiveness, it also measures efficiency. As with efficiency, there may be non-financial criteria for evaluating efficiency. But ultimately, efficiency is evaluated by the expense section of the income statement. If expenses are less than revenue and the organization has earned an “acceptable” profit, then we can say it is successful in efficiency. We can therefore say that the objective of the income statement is to demonstrate both the effectiveness and efficiency of the organization.

For not-for-profit organizations (N-F-P) however, these objectives are not as useful. Without a good measure of effectiveness, measurement of efficiency become almost meaningless. If n-f-p accounting system cannot measure effectiveness (as can profit seeking accounting systems), what then is their use? They are most often employed to control public resources i.e. each person given custody of or access to public resources should report back as to how they were used. The public can then hold the person accountable for the proper use of the resources. This means that the income statement is only limited to use in judging effectiveness. Both the nature of non profit organizations and the objectives of their financial reporting have given rise to a particular accounting method, i.e. the use of “fund accounting”

1.2 MEANING AND DEFINITION

It is very important to understand the meaning of fund in this context. In normal conversation “fund” means simply, a resource of money. That is not the meaning “fund” has in Fund Accounting. In fund accounting, “fund” means a **distinct entity within a larger entity**. A separate journal entry ledger will be kept and separate financial statements will be kept for each fund. The fund accounting concept can be used to define very clearly the purposes for which the resources are to be used, and who is to be held accountable for the resources. Furthermore the definition will be discussed along with the other principles in the next chapter.

1.3 CLASSIFICATION OF NOT-FOR-PROFIT ORGANIZATIONS

Generally, organizations could be classified either based on their objectives or their ownership. If organizations are classified by their:

1. Objectives

a. Commercial / for profit organizations- which emphasize on the making of profit

b. Non commercial/ not -for - profit organizations- which do not give emphasis on the making of profit

2. Ownership

a. Non-governmental (Private organizations) – are operating for the benefit of an individual proprietor or, as partners, a group of partners or shareholders.

b. Governmental organization – are operated for the benefit of society as a Whole.

A non profit (not- for profit) organization is a legal accounting entity that is operated for the benefit of society as a whole rather than for the benefit of an individual proprietor or a group of partners or shareholders. Thus, the concept of net income is not meaningful for

non-profit organization. A non-profit organization strives only to obtain revenue & support sufficient to cover its expenses.

Non-profit organizations comprise a significant segment of the country's economy.

Basically, the following are suggested ways of classifying NFP organizations.

1. GOVERNMENTAL UNITS

When thinking of governmental units, one tends to focus upon the federal government, or on the states within the federal government (state governments) or those major local governmental units or organizations within those governments. The federal government of Ethiopia is comprised of states & Local governmental units.

E.g.- Regions of the federal government of Ethiopia are:

Tigray	South nations & nationalities
Afar	Gambella
Amhara	Harari
Oromia	Addis Ababa
Somalia	
Benishangul /Gumuz	

- Local governmental units are

1. Zone (Counties) - administrative division of the largest unit of local

government

2. Kifleketema

3. Kebele

2. EDUCATIONAL INSTITUTIONS

These could be private, public or community

E.g. Colleges & University, schools.

3. HEALTH CARE PROVIDERS

-Theses could be private , public on community

e.g. Hospitals, clinics, nursing home, red Cross

4. VOLUNTARY HEALTH & WELFARE ORGANIZATIONS (VHWO)

E.g. NGOS like USAID, Save the children, Care Ethiopia etc.

5. OTHER N.F.P ORGANIZATIONS

These are organizations whose objectives and activities are different from the above four classifications.

E.g. Philanthropic foundations

Political parties

Civic organizations

Research & scientific organization

Professional associations

In the above classification, governmental units are being categorized as N.F.P organizations. However governmental units may undertake two types of activities.

- Profit making activates &
- Non-profit making activates

The governmental units which undertake non-profit activates & the other indicated four not-for-profit organizations are collectively known as Non-**business organizations**. It is those organizations that we discuss in this course that use fund accounting system.

Students beginning the study of fund accounting temporarily must set aside many of the familiar accounting principles for business

enterprises. Such fundamental concept of accounting theory for business enterprises as the nature of the accounting entity, the primacy of the income statement and the pervasiveness of the accrual basis of accounting have limited relevance in accounting for governmental units.

Thus the two types of non-business organization i.e. governmental units & the other NFPs (how, health care, educational, other) have several characteristics in common as well as differentiating features.

1.4 DISTINGUISH CHARACTERISTICS OF GOVERNMENTAL UNITS & NON- PROFIT ENTITIES

For all the similarities and differences in the mechanics of accounting and management of resources, there are very significant resources in what the two types of organizations do and how they operate. First consider the three distinctions noted by the financial accounting standards board (FASB) which characterize NFP organizations as

- receipts of significant amount of resources from resource providers who do not

- expect to receive either repayment of economic benefit proportionate to the

- resources provided

- operating purposes that are other than provide goods or services at a profit or profit

- equivalent

- Absence of defined ownership interests that can be sold , transferred, redeemed, or that convey entitlement to a share of residual distribution of resources in the event of liquidation of the organization.

putting this points in simple terms we might say that an NFP:

- gets money from people whom do not necessarily expect anything in return.(eg. Tax payers, donors to NGOs)

- is not trying to make money

- does not have ownership shares that can be sold or bought.

From the standpoint of the management of resources, for profit and not for profit organizations are similar different ways. For example both use the same type of resources as cash, fixed asset personnel, etc... Since both are using the same type of resources, both need good information for decision making, and both need to exercise careful control of the resources that they have. This means that mechanics of providing information and control system are similar for each. Both should imply accounting forms and other types of controls to restrict the use of assets and capture information, double entry accounting to record and classify that information, employing journals and ledgers, and then use those journals and ledgers as a basis to produce periodic financial reports which summarise the information in a meaningful way to guide decisions.

Despite the wide range in size and scope of governance, similarity & differences as the accounting treatment as compared to business organizations, Governmental units and other non-profit organizations would have the following common characteristics.

1. Organization to serve the society (citizens)

The basic principle of governmental philosophy is that governmental units exist to serve the citizens subject to their jurisdictions. Thus the citizens as a whole establish governmental units through the constitutional & charter process. In contrast, business enterprises are created by only a limited number of individuals.

2. General absence of profit motive

With few exceptions, governmental units render services to the citizenry with out the objective of profiting from those services. Business enterprises are motivated to earn profit.

3. Society as a principal source of revenue

As with governmental units, most non- profit organization depend on the general population for a substantial portion of their support. Because revenue from charges for their services is not intended to

cover all their operating cost. Exceptions are professional societies and the philanthropic foundations established by wealthy individuals or families, whereas the citizenry contributions are mostly involuntary Taxes. Citizen's contribution to non-profit organizations is voluntary donations. There is no comparable source for business enterprise.

N.B it is important to know about types of taxes for the future topics. **Tax** is an involuntary contribution from the society to the government. based upon their assessment, taxes could be classified into -

i) Self assessed taxes: - taxes, which are assessed and declared by the tax payer

e.g. Income tax, value added tax

ii) Government assessed taxes:- taxes determined and levied by the governmental authorities.

e.g. property tax , customs duty, Excise Tax

4. Importance of budget

Governmental accounting systems as we have seen are employed by government resources. That is each person given custody of or access to resources should report back as to how they were used. The government can then hold the person accountable for the resources. This means that budget become highly important in governmental entities. Since expenditures are divorced from revenue collections, the use of governmental resources is compared to the budget. The four-proceeding characteristics of non - profit organizations also cause their annual budget to be as important as for governmental units. Non-profit organizations may employ object budget, programming budget or performance budget.

5. Stewardship for resources

A primary responsibility of governmental units in financial reporting is to demonstrate adequate stewardship for resources provided by its citizenry. Non-profit organizations have a comparable responsibility to their donors but not to the same extent as governmental units.

1.5 USES AND USERS OF FINANCIAL REPORTS OF GOVERNMENTAL UNITS

Since financial reports are means of communicating the operation results & position, it is required for both business & non-business organizations. Financial reports could either be for a year (annual financial reports) or for a period less than a year (interim financial report). Every states and local governmental units are required to prepare annual financial reports, which would render information about the operation results & position to users. The users are categorized into as:

- i) Internal – who are the governing body of the states & local governmental
- ii) External - who are the society /citizenry

The governmental accounting standards board (GASB), which is one of the responsible body in developing a accounting & reporting standards for state & local governmental units in its concepts statement no.1 “objectives of financial reporting”, it established the following objectives.

GASB Reporting Objectives

I. Financial reporting should assist in fulfilling governmental duty to be publicly accountable & should enable users to assess that accountability by:

- a) Providing information's to determine whether current year revenues were sufficient to pay for current year services.
- b) Demonstrating whether resources were obtained & used in accordance with the entities legally adopted budget &

demonstrating compliance with other finance related or contractual requirements.

- c) Providing information to assist users in assessing the service efforts, costs & accomplishment of the governmental entity.

II. Financial reporting should assist users in evaluating the operating results of the governmental entity the year by:

- a) Providing information about sources and uses of financial resources.
- b) Providing information how it financed its activities and met its cash requirements.
- c) Providing information necessary to determine whether its financial position improved or deteriorated as a result of the year's operations.

III. Financial reporting should assist users in assessing the level of services that can be provided by the governmental entity and its ability to meet its obligations as it become due by.

- a) Providing information about its financial position and condition
- b) Providing information about its and other non-financial resources.
- c) Disclosing legal or contractual restrictions on resources and the risk of potential loss of resources.

It can be understood from the statement that **Accountability** is the cornerstone of all

financial reporting in government. Accountability requires governments to answer to the citizens, to justify the raising of public resources and the purposes for which they are used. Governmental accountability is based on the belief that citizenry has a "right to know" a right to receive openly declared facts that may lead to public debate by the citizens and their elected representatives. Financial reporting plays a major role in fulfilling governments duty to be publicly accountable in a democratic society. the GASB believe that

inter period equity is a significant part of accountability and is fundamental to public administration. It therefore needs to be considered when establishing financial reporting objectives. In short financial reporting should help

users assess whether current year revenues are sufficient to pay for services provided that year and whether future taxpayers will be required to assume burdens for services previously provided.

Financial reports of Non profit organizations- Voluntary health and welfare organizations, college and universities, Hospitals, religious organizations and others- have similar uses but, in recognition of the fact that the financial operations of NFPs are generally not subject to as detailed legal restrictions as are those of governments,

The financial accounting standards board believes the financial reports for not-for-profit organizations should provide

1. Information useful in making resource allocations decisions;
2. Information useful in assessing services and ability to provide services;
3. Information useful in assessing management stewardship and performance; and
4. Information about economic resources, obligations, net resources and changes in them.

Note the objectives of financial reporting for governments and for non-profit entities stress the need for public to understand and evaluate the financial activities and management of these organizations.

Government Financial Reporting

Serious users of government financial information have the need for much more detail than what is found in the audited general-purpose financial statement (GPFS). Much of that detail as well as the auditors report and the GPFS is found in the governmental reporting entity's Comprehensive Annual Financial Report (CAFR) which is considered

as the entity's official Annual report published as a matter of public record.

Government financial reporting, Comprehensive annual financial report (CAFR) contains three main sections,

- I. An introductory section
- II. A Financial section
- III. A statistical section

I) Introductory section

Introductory materials include such obvious but some times forgotten items as title page and contents page, the letter of transmittal and other material deemed appropriate by management. The letter of transmittal may be literally that a letter from the chief finance officer addressed to the chief executive and the governing body of the governmental unit- or it may be a narrative over the signature of the chief executive. In either event the letter of narrative material should cite legal and policy requirement for the report and discuss briefly the important aspects of the financial condition and financial operations of the reporting entity as a whole of the entity's funds and account groups. significant changes since the prior annual report and changes expected during the coming year should be brought to the attention of the reader of the report.

II) Financial section

The financial section of a comprehensive annual financial report (CAFR) should include

- An Auditors Report
- General purpose financial Statement (GPFS)
 - Combining and individual fund and account group statements and schedules.

The financial section has sufficient information to disclose fully and present fairly the financial position and results of its operation during

the fiscal year. In addition agreements with creditors and others provide constraints over the financial activities and introduce financial reporting requirements. In order to make it possible to determine and demonstrate compliance with laws, regulations and agreements using fund accounting system, indicating the nature of each fund type and account group prepare combined statements in which financial data are presented in a columnar form for each fund type and account group used by the reporting entity. The five combined statements that comprise the GPFS and that must be included in the financial section of a CAFR are

1. Combined balance sheet- all fund types and account groups
2. Combined statement of revenues, expenditures and changes in fund balances- all governmental fund types.
3. Combined statement of revenues, expenditures and change in fund balances- budget and actual-general and special revenue fund types, and similar fund types for which annual budgets have been legally adopted.
4. Combined statement of revenue, expenses, and changes in retained earnings (or equity)- all proprietary fund types.
5. Combined statement of cash flows- all proprietary fund types and non-expendable trust funds.

The notes to the financial statement are also an integral part of the GPFS.

III) Statistical Section

In addition to the introductory section and the financial section the report should contain the statistical section, which presents tables and charts showing social and economic data, financial trends and the fiscal capacity of the government in detail needed by readers who are more than casually interested in the activities of the governmental unit.

1.6 SIMILARITIES AND DIFFERENCES BETWEEN GOVERNMENTAL AND COMMERCIAL ENTITIES

Similarities

1. Impact of legislative process

The federal, state & local laws & regulations would have an impact upon both Governmental & commercial entities. However the level of legislative impact is not as strong for commercial units as it is for governmental entities.

2. Stewardship for Resources

Since the resources of commercial entities are provided by the owners themselves, they are taking full responsibility or the accountant along with the owner will be taking the responsibilities for the stewardship of resources. In the same way, members of the governmental entities should demonstrate adequate stewardship for resources.

3. Importance of Budget

The overall nature of governmental & commercial entities require a plan of expected expenditure and income to be implemented for both entities. it is important to employ relative budgets as per their accounting entities.

Differences

1. Profit motive

Commercial units have a presented profit motive as part of their objectives where as governmental units with some exceptions do not operate with the objective of earning a profit.

2. Governance

The legislative and executive branches of a governmental unit share the responsibilities for their governance where as in the case of

commercial entities, it is governed by elected or appointed directors or managers.

3. Basis of accounting

The modified accrual basis of accounting is mostly used by some governmental units but in case of commercial entities the basis of accounting is the accrual basis.

4. Source of revenue in nature

The primary source of revenue for commercial entities is through sales or services they provide, whereas in case of governmental units, with some exceptions, the main source of revenue is through fund or donations.

5. Beneficiaries

Governmental units are operating for the benefit of the citizenry whereas commercial entities are operating for the interest and benefit of the owners.

1.7 SOURCE OF ACCOUNTING STANDARDS

Accounting and financial reporting standards for state and local governmental units are established by the governmental accounting standards board (**GASB**).

Accounting and financial reporting standards for profit seeking business are established by the financial accounting standards board (**FASB**)

The GASB and the FASB are parallel bodies under the oversight of the Financial Accounting Foundation. They are referred to as “independent standard setting boards” in the private sector. Before the creation of the GASB & FASB, financial reporting standards were set by groups sponsored by professional organizations. Before 1934 in US, there was no governmental accounting standard. But by 1934, to overcome this confusion & scandal specially in municipality accounting, the Municipal Finance Officers Association (MFOA) formed, the **National**

Committee on Municipality Accounting (NCMA) to assure accounting standard for municipalities. By expanding its scope, the NCMA in 1949 was reorganized as **National Committee on Governmental Accounting (NCGA)** to establish accounting standards for states and local governmental units. In 1974, the committee was again reorganized as a council and formed the **National Council of Governmental Accounting (NCGA)**. In 1984 the council was again reorganized as a board parallel to FASB and was renamed as **Governmental Accounting Standards Board (GASB)**.

Authority to establish accounting principles (financial reporting standards for non profit organizations) is split between the GASB and the FASB. Because a sizable number of non profit organizations (particularly colleges, universities & hospitals) are governmentally related. But many others are independent of governmental units. Accordingly the GASB has the responsibility for establishing accounting & financial reporting standards for not for profit organizations whose financial statements may be combined with the financial statements of state and local governmental reporting entities, or which are considered governmentally owned.

The FASB has the responsibility for establishing accounting and financial reporting standards for non-governmental non-for profit organizations. Both the GASB and the FASB have issued concept statements, which are intended to communicate the framework within which the two bodies strive to establish consistent financial reporting standards for entities within their respective jurisdictions.

The financial accounting foundations appoints the members of the two boards & supports the operating expenses of the boards by obtaining contributions from business corporations, professional organization of accountants, financial analysts, CPA firms and other groups concerned with financial reporting.

Check Your Progress Exercise

1. Explain organizational classification and organizations using fund accounting system.

2. Compare and contrast commercial and governmental accounting.

3. Explain the classifications of n-f-p organizations.

4. Describe the establishment of sources of accounting standards for n-f-p organizations.

5. Describe in brief the main points of GASB “financial reporting objectives”.

6. Describe the contents of government financial reports.

1.8 SUMMARY

It should be clear that an NFP will usually have a specific purpose for its existence, unlike FP, to increase the wealth of its owners. NFPs also have sub purposes within its main purpose. it might be development, humanitarian social well-being etc.. within it, to fulfil that purpose, it may undertake various activities. it follows then, that the resources obtained by an NFP will only be used for its specific purpose(s).

1.9 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Refer to topic 1.3
2. Refer to topic 1.6
3. Refer to topic 1.3
4. Refer to topic 1.7
5. Refer to topic 1.5
- d) Refer to topic 1.5