Government and Not for Profit Accounting Concepts and Practices 10th edition Granof Solutions Manual

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Chapter 1

The Government and Not-For-Profit Environment

Questions for Review and Discussion

1. The critical distinction between for-profit businesses and not-for-profits including governments is that businesses have profit as their main motive whereas the others have service. A primary purpose of financial reporting is to report on an entity's accomplishments — how well it achieved its objectives. Accordingly, the financial statements of businesses measure profitability, their key objective. Financial reports of governments and other not-for-profits should not focus on profitability, since it is not a relevant objective. Ideally, therefore, they should focus on other performance objectives, such as how well the organizations met their service goals. In reality, however, the goal of reporting on how well they have achieved such goals has proven difficult to attain and the financial reports have focused mainly on finance-related data.

2. Governments and not-for-profits are "governed" by the budget, whereas businesses are governed by the marketplace. The budget is the key political and fiscal document of governments and not-for-profits. It determines how an entity obtains its resources and how it allocates them. It encapsulates most key decisions of consequence made by the organization. In a government the budget is not merely a managerial document; it often is equivalent to a law.

3. Owing to the significance of the budget, constituents want assurance that the entity achieved its revenue estimates and complied with its spending mandates. They expect the financial statements to report on how the budget was administered.

4. ***Interperiod equity*** is the concept that this year's services are paid for with this year's revenues, as opposed to shifting the payment burden to future years. Financial reporting must provide information that the reader can use to assess the extent to which interperiod equity has been achieved. Therefore, it must determine and report upon the economic costs of the goods and services provided (not merely the cash costs) and of the taxpayers' contribution toward covering those costs.

5. The notion of matching expenditures to revenues may be less relevant for governments and not-for-profits than for businesses because there may be no connection between revenues generated and the quantity, quality or cost of services performed. An increase in the demand for, or cost of, services provided by a homeless shelter would not necessarily result in an increase in the amount of donations that it receives. Of course, governments in particular are concerned with assessing the extent to which interperiod equity was achieved. It is therefore important that costs be assigned, not necessarily to the periods in which related

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revenues are recognized, but rather to those in which constituents benefited from the goods and services that the government provided to them.

6. Governments must maintain an accounting system that assures that resources that are limited to being used for a specific purpose are not inadvertently expended for inappropriate purposes. Moreover, statement users may need separate information on these resources, by category or purpose of limitation, and the resources that available for any government purpose. In practice, these requirements have led governments to adopt a system of "fund" accounting and reporting.

7. Even governments within the same category may engage in different types of activities. For example, some cities operate a school system whereas others do not. Those that are not within the same category may have relatively little in common. For example, a state government shares few characteristics with a city.

8. If a government has the power to tax, then it has command over, and access to, resources. Therefore, its fiscal well-being cannot be assessed merely by measuring the assets that it "owns." For example, an assessment of the fiscal condition of a city should consider the wealth of the residents and businesses within the city, their earning capacity, and the city's willingness to exploit its tax base.

9. Many governments budget on a cash or near-cash basis. However, the cash basis of accounting does not provide adequate information with which to assess interperiod equity. Financial statements that satisfy the objective of reporting on *interperiod equity* may not satisfy that of reporting on *budgetary compliance*. Moreover, statements that report on either interperiod equity or budgetary compliance are unlikely to provide sufficient information with which to assess *service efforts and accomplishments.*

10. Measures of service efforts and accomplishments are more significant for governments and not-for-profits because their objectives are to provide service. By contrast, the objective of businesses is to earn a profit. Therefore, businesses can report on their accomplishments by reporting on their profitability. Governments and not-for-profits must report on other measures of accomplishment in addition to financial.

11. It is more difficult to distinguish between internal and external users in governments than in businesses because constituents, such as taxpayers, may play significant roles in establishing policies that are often considered within the realm of managers. Also, legislators are internal to the extent they set policy, but external insofar as the executive branch must account to the legislative branch.

12. The FAF did consider giving the FASB authority over all business-like entities—such as colleges and universities, hospitals, and utilities—regardless of their status as governments, nongovernmental not-for-profits, or businesses. Some organizations and individuals that use the financial statements of such entities, including lenders and accrediting groups, focus on all entities of a particular type

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and would have benefitted from these entities following the same accounting standards. The FAF chose to divide these entities between the FASB and the GASB by governmental status based on the view that although they operate in a similar manner and provide the same goods and services, different standards may be necessary because of governments' unique stakeholders, methods of financing, among other distinctions. (As a practical matter, the major governmental trade associations refused at the time to condone any governmental entities being subject to FASB standards and threatened to withdraw its support for the GASB and create a new standards-setting organization. The FAF had little choice but to comply with their demands.)

Exercises

EX 1-1

1. a
2. d
3. c
4. c
5. b
6. c
7. d
8. c
9. b
10. c

EX 1-2

1. b
2. b
3. d
4. b
5. a
6. a
7. b
8. b
9. a
10. b

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EX 1-3

a. 1. The Governmental Accounting Standards Board (GASB) is the independent organization that establishes and improves standards of accounting and financial reporting for U.S. state and local governments. Established in 1984 by agreement of the Financial Accounting Foundation (FAF) and 10 national associations of state and local government officials, the GASB is recognized by governments, the accounting industry, and the capital markets as the official source of generally accepted accounting principles (GAAP) for state and local governments.

Accounting and financial reporting standards designed for the government environment are essential because governments are fundamentally different from for-profit businesses. Furthermore, the information needs of the users of government financial statements are different from the needs of the users of private company financial statements. The GASB members and staff understand the unique characteristics of governments and the environment in which they operate.

The GASB is not a government entity; instead, it is an operating component of the FAF, which is a private sector not-for-profit entity. Funding for the GASB comes primarily from an accounting support fee established under the Dodd-Frank Wall Street Reform and Consumer Protection Act, as well as the licensing of its publications. Its standards are not federal laws or regulations and the organization does not have enforcement authority. Compliance with GASB's standards, however, is enforced through the laws of some individual states and through the audit process, when auditors render opinions on the fairness of financial statement presentations in conformity with GAAP.

2. The mission of the GASB is:

To establish and improve standards of state and local governmental accounting and financial reporting that will:

- Result in useful information for users of financial reports, and
- Guide and educate the public, including issuers, auditors, and users of those financial reports.

The mission is accomplished through a comprehensive and independent process that encourages broad participation, objectively considers all stakeholder views, and is subject to oversight by the Financial Accounting Foundation's Board of Trustees.

3. Based on the GASB's White Paper, *Governmental Accounting and Financial Reporting is and Should be Different,* the key environmental differences between governments and for-profit business enterprises are:

Organizational Purposes. The purpose of the government is to enhance or maintain the

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well-being of citizens by providing public services according to the established goals. A government's financial reports should give creditors, legislative and oversight officials, citizens, and other stakeholders the information necessary to make assessments and decisions relevant to their interests in the government's accomplishment of its objectives. In contrast, business enterprises focus on wealth creation, interacting only with those segments of society that fulfill their mission of generating a financial return on investment for shareholders. Its primary focus of reporting has been on earnings and its components, with little or no explicit focus on nonfinancial measures of performance.

Sources of Revenue. The principal source of revenue for government is taxation, which is a legally mandated involuntary transaction between individual citizens and businesses and their government. The principal source of revenue of business enterprises is voluntary exchange transactions between willing buyers and sellers.

Potential for Longevity Because of their ongoing power to tax and because of the ongoing need for public services, governments rarely liquidate. The possibility of achieving longevity, however, is not as likely for business enterprises. Business enterprises will go out of existence if, for an extended period of time, they are unable to sell their products or services for more than it costs to produce them. Further, a business may also cease to exist if it is acquired by another entity.

Relationship with Stakeholders. The governments should meet a standard of accountability, since the citizens are interested in evaluating inter-period equity by determining whether current taxpayers and users of government services fully financed the costs of providing current-period services or whether taxes and user fees from prior or future periods were, or will be, needed to finance the current services provided. For business, their financial reports show changes in equity of the enterprise during the current period.

Role of the Budget. For governments, a budget takes on a special legal significance. Governmental budgets are expressions of public policy priorities and legally authorize the purposes for which public resources may be spent. In fact, governmental budgets can be the primary method by which citizens and their elected representatives hold the government's management financially accountable. For business enterprises, the budget represents an internal financial management tool that is controlled entirely by management and is considered proprietary in nature.

b. 1. The purpose of the Government Finance Officers Association is to enhance and promote the professional management of governments for the public benefit by identifying and developing financial policies and best practices and promoting their use through education, training, facilitation of member networking, and leadership.

The objectives of the GFOA are:

- Expert Knowledge. Continue to be recognized as a leading source of expert knowledge in public financial management by exercising leadership in research, recommended practice and policy development and information dissemination.

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- Education and Training. Enhance the expertise and professionalism of financial managers and policy makers and provide recognition for their achievements.

- Leadership Development. Engage in efforts to assist finance officers to develop the skills and capabilities necessary to enable them to become organizational leaders as well as technical experts.

- Raising Public Awareness of Sound Financial Policy and Practice. Take leadership in promoting public awareness of policies and practices that enhance sound financial management of public resources.

- Enhanced Cooperation. Cooperate with and complement the services provided by other organizations (U.S., Canadian and international) to increase the effectiveness of GFOA.

- Strategic Use of Technology. Provide information and analytical tools to help governments identify and apply appropriate, economical technologies to support efficient resource allocation, quality services and effective decision-making and to promote citizen involvement.

- Association Operations. Conduct the operations of the Association in a manner that exemplifies the highest standards of financial management and member service.

2. The GFOA established the Certificate of Achievement for Excellence in Financial Reporting Program (COA Program) in 1945 to encourage and assist state and local governments to go beyond the minimum requirements of generally accepted accounting principles to prepare annual comprehensive financial reports that evidence the spirit of transparency and full disclosure and then to recognize individual governments that succeed in achieving that goal.

Reports submitted to the COA Program are reviewed by selected members of the GFOA professional staff and the GFOA Special Review Committee (SRC), which comprises volunteers with expertise in public-sector financial reporting and includes financial statement preparers, independent auditors, academics, and other finance professionals.

3 The number of state and local governmental entities that were awarded the COA for the fiscal year 2024 are:

Certificate of Achievement for Excellence in Financial Reporting 2024 Program Results:

College/University (using only proprietary funds)	614
College/University (using governmental funds)	207
Council of Governments	70
County, Large	529
County, Small	845
Enterprise Fund	3,333

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Investment Pool	85
Municipality, Large	341
Municipality, Small	5,968
Public Employee Benefit Plans or Systems	837
School District	3,277
Special District	1,684
State	149
Total award recipients	17,939

https://lf.gfoa.org/WebLink/CustomSearch.aspx?SearchName=COA&dbid=0&repo=GFOA

Problems

P. 1-1.

a. The authority's cash requirements in Year 1 would be as follows (in millions):

Wages, salaries and other operating costs		$6.0
Purchase of equipment	$10.0	
Less: Issuance of bonds	10.0	0.0
Interest on bonds		0.5
Purchase of additional equipment		0.9
Total cash outlays (revenue requirements)		$7.4

b. In Year 2, they would be:

Wages, salaries and other operating costs	$6.0
Interest on bonds	0.5
Total cash outlays (revenue requirements)	$6.5

c. In Year 10, they would be:

Wages, salaries and other operating costs	$6.0
Interest on bonds	0.5
Repayment of bonds	10.0
Total cash outlays (revenue requirements)	$16.5

d. The budgeting and taxing policies fail to promote interperiod equity. The *economic* costs incurred by the authority — the wages, salaries, other operating costs, and portion of equipment consumed — were the same each year. Yet, tax payments will depend on when the equipment was purchased and when the debt was repaid. Taxpayers of Year 10 will have to pay for equipment that provided services to the taxpayers of the previous nine years.

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Interperiod equity could be achieved by budgeting on an *accrual* rather than a cash basis. The budget would then include an annual charge of $1.3 million for depreciation — $1 million on the ten-year equipment; $0.3 million on the three-year equipment. Annual required revenues for the first three years would be $7.8 million:

Wages, salaries and other operating costs	$6.0
Interest on bonds	0.5
Depreciation on equipment	1.3
Total revenue requirements	$7.8

Beginning in Year 4, with the three-year equipment fully depreciated, the total revenue requirements would be $7.5 million.

This practice might, however, be objectionable to some taxpayers because it requires that they contribute cash to the authority in years prior to those in which it will actually be expended. Thus, for example, at the end of Year 1 the authority will have a cash "reserve" of $0.4 million — the difference between the $7.8 million in taxes collected and the $7.4 million in cash outlays. The authority could also achieve interperiod equity by issuing serial bonds (those in which a portion of the principal matures each year over the life of the issue) or by establishing and contributing to a debt service "sinking fund." By taking either of these approaches, the authority would, in effect, be repaying the bonds over the period in which the equipment is used and thereby matching equipment costs with equipment benefits.

P. 1-2

1. The information provided should, by itself, pose no obstacle to approving the loan. For sure, revenues just cover expenses, allowing for no excess to cover the debt service on the loan and the additional operating expenditures that will be incurred when the classroom building is put into use. The key issue facing a loan officer, however, is whether the church *members* are both willing and fiscally able to pay for the new facility and to cover the additional operating costs. The fiscal capacity of the church cannot be assessed independently of that of its members.

   The financial statements reveal that the church's assets will have a fair value of $7.2 million (existing equipment and buildings and the new building plus cash and investments) when the classroom building is completed. If some or all of these assets are used to secure the loan, then the bank may have a reasonable cushion against default. However, fair values of churches or other special-purpose facilities are notoriously unreliable. Moreover, for obvious reasons, banks are reluctant to foreclose on local churches.

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2. The loan officer may wish to review the financial statements for "smoking guns" such as contingent liabilities, litigation, or unusual transactions. However, assuming that none are found, there is likely to be little other information in the financial statements to provide the basis for a loan decision.

   A standard practice of lenders is to examine financial statement information for the past three to five years. Doing so indicates whether potential borrower's fiscal capacity has been improving or deteriorating and identifies instances in which the current-year financials are out of line with the preceding year's results.

3. If the loan officer were to approve the loan, he would likely do so in large measure because he has had a business relationship with members of the church and has confidence in their ability to manage the church and assure that the loan is repaid. Accordingly, he would probably want to review whatever information is available as to the character and credit worthiness of key church members and officers.

4. As implied in part a, as a matter of policy the church, like many not-for-profit organizations, generates only enough revenues to meet its expenses. If the members opt to enhance the level of services provided by the church by building a new facility — and thereby increase expenses — then presumably they will also increase their dues and contributions.

   Financial statements of many not-for-profits are inadequate for making loan decisions because they report only on the entities themselves. However, the entities' true fiscal condition cannot be determined apart from that of their constituents.

P. 1-3

The objective of budgetary compliance can best be served by recording each transaction on the same basis as it is budgeted — in this case, on a *modified cash* basis. That of interperiod equity can best be achieved by identifying the economic substance of each transaction and recording it when it has its substantive economic impact — that is, on an *accrual* basis.

1. Budgetary compliance: No expenditure recognized in 20X0. Recognize the $128,000 in wages and salaries as an expenditure entirely when paid in 20X1.

   Interperiod equity: Recognize the amounts when earned, entirely in 20X0.

2. Budgetary compliance: Recognize cost of the pension contribution when the $170,000 payment was made in 20X1.

   Interperiod equity: Recognize the actuarially required pension contribution of $225,000 in 20X0, the year the employees earned the benefits, irrespective of the city's actual cash contribution.

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3. Budgetary compliance: Recognize the vehicle cost when the cars were paid for, $105,000 in 20X0.

   Interperiod equity: Recognize the vehicle cost over the three-year period in which the vehicles will be used, $35,000 per year.

4. Budgetary compliance: Recognize the $1,000 in interest revenue when received in 20X1, inasmuch as the interest revenue would increase the value of the marketable securities and marketable securities are included within the government's definition of cash.

   Interperiod equity: Recognize the interest when earned, in 20X0.

5. Budgetary compliance: Recognize the $10 million of bond proceeds and the $10 million expenditure to acquire the building in 20X0. Recognize the repayment of the bonds as payments are made, $400,000 per year for 25 years (presuming the full amount is paid).

   Interperiod equity: Recognize the cost of repaying the bonds as payments are due, $400,000 per year for 25 years, regardless of how much actually is paid.

6. Budgetary compliance: Recognize the issuance of the bonds and the purchase of the building in 20X0. Recognize the expenditure for use of the building when it is paid for, $10 million in year 25.

   Interperiod equity: As previously stated, recognize the cost of the building as it is used, irrespective of when it is paid for, in this case $400,000 per year for 25 years to reflect the cost of repaying the bonds.

7. Budgetary compliance: Recognize the entire $120,000 in license fee revenue in 20X0 as cash is received.

   Interperiod equity: Recognize the license fee revenue over the period covered by the license and in which the related inspections will be carried out, thus $60,000 for the half-year of 20X0 and $60,000 for 20X1.

8. Budgetary compliance: Recognize the $300,000 borrowed as a revenue when received in 20X0, and then as an expenditure when repaid in 20X1. Note that in this example, the increase in cash may be considered "other sources of funds" rather than as revenue. The impact on fund balance is the same, however.

   Interperiod equity: This transaction would result in an increase in cash and an offsetting increasing in a payable. No recognition would be given as a revenue or an expenditure to either the receipt of the amount borrowed or its subsequent repayment.

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P. 1-4

1. a. The statements are clearly silent as to the accomplishments of the university. Indeed, they give no indication either as to what the university's objectives are or whether they have been met.

   b. Efficiency is a ratio of inputs to outputs (resources to results). Inasmuch as the statements do not report on results, the user can make no assessments as to efficiency.

   c. The statements give no information as to the nature, condition, or market value of the university's physical properties. Equally significant they give no clues as to what the university's plant requirements are for the present, let alone what they will be in the future.

   d. The statements provide no indication as to what the university's fiscal requirements will be in the future. They say nothing, for example, about anticipated student enrollments, state appropriations, research grants, program requirements, etc. Accordingly, no comparison can be made between 20X0 and 20X1.

   e. The statements indicate that the ratio of cash to both short- and long-term obligations is approximately the same in 20X1 as it was in 20X0. Assuming that the cash balance was adequate for 20X1 it appears that it will be adequate for 20X2. However, the statements give no indication as to whether cash inflows can be expected to be the same in the future as they were in the past or whether there will be new demands for cash (e.g., for maintenance and repairs or for new facilities or programs).

2. Each of the questions is consistent with the objectives. They demonstrate that the financial statements of not-for-profits, if limited to the types of data included in business-type statements, cannot possibly fulfill all the GASB or FASB objectives. These statements provide insufficient information to assess past performance or the adequacy of current resources to meet future requirements. At the very least they would have to contain information on the entity's goals and accomplishments.

P. 1-5

1. Among governments that should be considered are towns, townships, cities, counties, states, school districts, utility districts, road districts, library districts, hospital districts, community college districts, airport authorities, transportation districts, and other types of special-purpose districts.

2. The overlapping governments may rely on the same property or citizens for their tax revenues. Thus, to determine the "fiscal capacity" of one government it may be necessary to assess that of the others. For example, the outstanding debt of the school district must be considered in evaluating the borrowing capacity of the

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overlapping city, because the debt of both governments will have to be repaid from taxes on the same property.

P. 1-6

a. (1) Inasmuch as the city budgets on a cash basis, delaying the payment of bills by one week would reduce the budget deficit, shifting cost to the next year. It would have no impact on the accrual-based financial statements and only a very minor direct impact on the city's substantive economic well-being (i.e., the city would have the use of the required cash for an additional few days).

(2) Speeding-up recognition of property taxes would also reduce the budget deficit but have no impact on the financial statements and would shift revenue from one year to another. It would have no direct impact on the city's substantive economic well-being as it would not affect the timing of actual cash collections.

(3) Delaying the recognition of expenditures would also reduce the budget deficit, have no impact on the financial statements, and have no impact on the city's substantive economic well-being. Like speeding-up recognition of property taxes, it would not affect the timing of actual cash collections or disbursements.

(4) Deferring maintenance would reduce the budget deficit and reduce the expenditures reported in the accrual-based financial statements. Assuming that the initially planned maintenance expenditures were necessary (and that the city's maintenance schedule was optimal), the change would have a negative effect on the city's substantive well-being. It would likely result in increased expenditures in the future.

a. Each of these proposals may substantively affect the city's financial well-being *indirectly* (or in the case of item #4 directly) in that they would enable the city to legally balance its budget and thereby avoid the adverse consequences of a deficit. The benefits would not last, however, because actions that push recognition of expenditures to the future or recognize future collections in the current year will adversely affect the city's ability to balance its budget in future. Sophisticated analysts might recognize the city's measures as gimmicks and "one-shots" that would create fiscal pressures in the future. They might thereby downgrade the city's credit rating or take other actions that would have a negative impact on the city's fiscal well-being.

b. Accounting principles do *not* directly affect an entity's economic well-being. However, if they change the data presented in budgets or other financial reports that are relied upon to make legal determinations, credit assessments, or other decisions, their *indirect* impact can be profound. As a consequence of those decisions the city can be denied loans or grants (or have to incur higher interest costs) or alter the allocation of its resources. In this example, the decision in item #4 was not merely a

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change in an accounting principle. It was a substantive change in operating practice – i.e., a delay in performing needed maintenance.

P. 1-7

There are no clear-cut answers to these questions. It addresses an issue that has been on the GASB's agenda since the board was first established and will be dealt with in greater depth later in the text in the chapter on business-type activities.

1. In a broad sense, the financial reporting objectives of the private company are likely to be similar to those of the government. Financial reporting should provide information on the past performance and current financial condition of the department. To be sure, the owners of the private company measure performance in terms of profitability, whereas the citizens of the town are concerned mainly with "service" (subject to the constraint that costs are covered by fees). This difference alone may have important implications as to the types of data that are collected and how they are reported. From a practical perspective, however, the "traditional" information requirements — data on revenues, expenditures, assets and liabilities — are likely to be the same.

2. In light of the requirement that the department was expected to break-even, there are likely to be few operating differences between the information needs of the managers of the department as owned and operated by the private company as opposed to the town.

P. 1-8

1. Assuming that the PAC is profit oriented and is thereby interested in maximizing the present value of incremental cash flows, the decision is straight-forward:

Additional annual net cash flows: 20 students x 50 weeks x incremental revenues of $30 ($130 less $100)	$30,000
Present value of an annuity of $1 for 3 periods at 10 percent	2.4869
Present value of net cash flows	$74,607

   Because the present value of the incremental cash inflows exceeds the asset cost of $60,000, the PAC should acquire the asset.

2. The CYA, by contrast has no such convenient algorithm to rely upon. The key question faced by the CYA is whether alternative uses of the $60,000 would better enable it to fulfill its mission. The limited information provided is inadequate to make a decision.

3. The objective of not-for-profits such as the CYA is to serve their communities, not to earn profits or maximize cash flows. Hence, the conventional discounted cash flow capital budgeting model is not appropriate because it focuses on cash flows. To be appropriate for a not-for-profit, a capital budgeting model would have to take

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into account the benefits that relate specifically to the organizations' unique objectives.

Nevertheless, for some capital budgeting decisions, the conventional discounted cash flow approaches may be appropriate. These would include purchase decisions when, for example, the benefits to be derived from the asset under consideration are cash savings rather than enhanced service.

P. 1-9

1. Were the city to accept the offer, its total savings would be only $8.1 million.

Wages and salaries	$4.0
Supplies	2.6
Other cash expenditures	1.3
Rent	0.2
Total savings	$8.1

The cost of obtaining the service from the private company would be $8.5 million. Hence the offer should be rejected.

For purposes of this decision, the cost of $8.9 million used to establish billing rates is not relevant. It includes allocated overhead costs, some of which could not be reduced were the city to accept the offer.

2. The total savings to the city would be unaffected by its allocation policy. They would remain at $8.1 million. Therefore, if the offer were rejected when costs were allocated, it should also be rejected when costs were not allocated. The $7.9 million is no more relevant than the $8.9 million. The relevant amount is still the $8.1 million in expected savings.

   There may be sound reasons for the city to allocate overhead costs for purposes of establishing billing rates. However, the allocated costs are not relevant for the decision whether to perform a service internally or acquire it externally.

P. 1-10

a.

1. The reported pension cost should be based on the actuarially determined contribution, not on the actual cash contribution. (As we will learn later in the chapter on pensions, the amount recognized as expense each year actually is based on changes in the amount of the pension liability, rather than on the actuarially determined contribution amount.)

2. The contribution to the rainy-day reserve should be accounted for as an internal designation of resources. The accounting should make clear that total assets of the government are not affected by the arbitrary, nonbinding

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management decision to set aside cash for a particular purpose. Thus, the transfer should affect only asset accounts, not revenues or expenditures.

3. The securities should be accounted for at fair value. In that way the gain would not be recognized entirely in the year of sale—a year in which an increase in market price did not necessarily take place—and management could not pick the year to enhance its revenues.

4. The city could automatically report an annual maintenance expenditure equal to some predetermined amount (perhaps an average of expenditures over the previous five years.) The charge would be offset by a liability (e.g., "deferred maintenance"), which would be reduced only by actual maintenance outlays.

b. A fundamental objective of financial reporting is to report on budgetary compliance. To the extent that the financial reports are on an accrual basis whereas the budget is on a cash basis, they would not achieve this objective. Moreover, the reported budgetary expenditures, for both maintenance and (though to a lesser extent) pensions could be considered arbitrary — that is, not based on specific transactions.

P. 1-11

1. Per capita long-term liabilities (before change) = liabilities/population = $1,200,000,000/800,000 = $1,500

2. Per capita long-term liabilities (after change) = $1,800,000,000/800,000 = $2,250

3. a). The change in the accounting principle will increase the reported liabilities but will have no direct impact on the city's fiscal condition. The promises to employees and retirees will remain the same; hence future cash flows will also remain the same. Only the way "the story" is told will change.

b). Assuming that notes to financial statements provided the same information that would now be reported on the balance sheet, there is no reason why the analyst should change the city's bond rating. The analyst would have been (or most certainly should have been) aware of the existence, as well as the magnitude, of the pension obligation. In fact, that is how analysts responded to governments implementing GASB Statement No. 68, *Accounting and Financial Reporting for Pensions,* in the mid-2010s. If, however, the new rules required that the liability be computed differently and thereby better captured its true economic value the financial statements would have provided the analyst with improved information. This new information might give the analyst reason to change the rating.

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Questions for Research, Analysis and Discussion

1. The GASB in 2006 issued a "white paper," "Why Governmental Accounting and Financial Reporting Is—and Should Be—Different," which, as implied by the title, sets forth numerous reasons as to why governments are unique and therefore justify their own standards-setting organization. **The White Paper was updated in 2017.** The characteristics identified include:

   - Organizational purposes
   - Sources of revenue
   - Relations with stakeholders
   - Potential for longevity
   - Role of the budget

   In addition, the White Paper points to several other ways that governmental accounting differs from business accounting:

   - The reporting model has several unique features.
   - There are special issues regarding how to define the reporting entity.
   - Long-lived assets have different purposes (e.g., in governments they are not intended to generate cash flows).
   - They engage in numerous types of nonexchange transactions.

   The GASB White Paper is available on the organization's web site, https://gasb.org/projects/other-research-and-staff-projects.

   Not-for-profit entities have many of the characteristics of both governments and businesses. Some, like agricultural cooperatives, country clubs, or hospitals, are virtually the same as businesses. Others, such as health and welfare organizations, have more of the characteristics of governments. In reality, not-for-profit entities could legitimately be placed within the purview of either the GASB or the FASB. The decision to place not-for-profits within the purview of the FASB was influenced more by "political" considerations than by any fundamental organizational characteristics.

2. The GASB in its Concepts Statement 1, *Objectives of Financial Reporting*, explicitly recognizes that, "Financial reporting should provide information to assist users in assessing the service efforts, costs, and accomplishments of the governmental entity." Moreover, it had devoted Concepts Statement No. 2, *Service Efforts and Accomplishments Reporting* (SEA reporting) entirely to this objective. After 20 years of conducting research and constituent outreach on SEA reporting, the GASB issued in 2009 Concepts Statement No. 5, *Service Efforts and Accomplishments Reporting*--

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an Amendment of GASB Concepts Statement No. 2 and offers the strongest endorsement to date of enhanced SEA reporting. It has long been the position of many GASB members and constituents that SEA reporting should indeed be incorporated into annual comprehensive financial reports (ACFR). Nevertheless, many other constituents of the GASB believe that, even though information on SEA is important, it does not relate directly to *financial* reporting and should be reported separately from financial statements. Accordingly, the GASB has not yet formally proposed incorporating SEA information in the ACFR.

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