# *Government and Not for Profit Accounting Concepts and Practices 10th edition Granof Test Bank*

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# Chapter 1
# The Government and Not-For-Profit Environment

## TRUE/FALSE (CHAPTER 1)

1. The objectives of a typical government or not-for-profit entity include abstract goals that are more difficult to quantify than profit.

2. A government's budget may be backed by the force of law.

3. Governments have no need for an accounting system.

4. A government's constituents rely on general purpose financial statements for a considerable amount of information about their government.

5. Governments and not-for-profit entities may never engage in business-type activities.

6. Lenders use the financial statements of governments and not-for-profit entities just as they would those of businesses, that is, to help assess the borrower's credit-worthiness.

7. Financial statements, no matter how prepared, do not directly affect the economic worth of an entity.

8. The Federal Accounting Standards Advisory Board's standards do not apply to the federal Department of the Treasury.

9. Sarbanes-Oxley was passed in 2002 with the sole purpose of enhancing the independence of the GASB.

10. The Governmental Accounting Standards Board establishes generally accepted accounting principles for all state and local governments and all not-for-profit entities.



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## ANSWERS TO TRUE/FALSE QUESTIONS (CHAPTER 1)

1. True
2. True
3. False
4. True
5. False
6. True
7. True
8. False
9. False
10. False



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**MULTIPLE CHOICE (CHAPTER 1)**

1. A primary characteristic that distinguishes governments from businesses is _____
    a. The need to generate revenues equal to or more than expenditures/expenses.
    b. The importance of the budget in the governing process.
    c. The need to provide goods or services.
    d. The correlation between revenues generated and demand for goods or services.

2. A primary characteristic that distinguishes government from not-for-profits is _____
    a. The need to generate revenues equal to or more than expenditures/expenses.
    b. The ability to levy taxes.
    c. The need to provide goods or services.
    d. The correlation between revenues generated and demand for goods or services.

3. Which of the following characteristics distinguishes a government or not-for-profit entity from a business?
    a. There is always a direct link between revenues generated and expenditures/expenses incurred.
    b. Capital assets are used to produce revenues and save costs.
    c. Revenues are always indicative of demand for goods and services.
    d. The mission of the entity may include goals other than maximizing profit.

4. The most significant financial document provided by a government is the _____
    a. Balance sheet.
    b. Operating statement.
    c. Operating budget.
    d. Cash flow statement.

5. Which of the following statements is true?
    a. Governments may engage in activities like activities engaged in by for-profit entities.
    b. There are a small number of different types of governments.
    c. All governments engage in the same activities.
    d. Managers may have a long-term focus and thereby sacrifice the short-term liquidity of the entity.



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6. Which of the following activities is not an activity in which a government might engage?
    a. Selling electric power.
    b. Operating a golf course.
    c. Operating a bookstore.
    d. All of the above are activities that might be carried out by a government.

7. In which of the following activities is a not-for-profit entity least likely to engage?
    a. Providing educational services.
    b. Providing health-care services.
    c. Providing for terrorism defense.
    d. Retail sales of cookies

8. Which of the following can be affected by GAAP?
    a. Legal ability to issue bonds.
    b. Ability to balance the budget.
    c. Amount reported as employee pension plan contributions.
    d. Claims and judgments settled.

9. Which of the following characteristics is unique to governments?
    a. The ability to have activities financed with tax-exempt debt.
    b. The power to impose fees.
    c. The ability to issue tax-exempt debt.
    d. The ability to have activities financed by Federal grants.

10. To obtain a comprehensive understanding of a government's fiscal health, a financial analyst should obtain an understanding of which of the following?
    a. All the resources owned by the government.
    b. All the resources that may be summoned by the government.
    c. Demographic data about the residents served by the government.
    d. All of the above.

11. Which of the following is common to both governments and not-for-profit entities but distinguishes these entities from for-profit entities?
    a. The budget is a legal, financial document.
    b. Revenues are usually indicative of demand for goods or services.
    c. There is direct matching of revenues and expenses.
    d. There are no defined ownership interests.



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12. Which of the following is not a purpose of external financial reporting by governments?
    a. Assess financial condition.
    b. Compare actual results with the budget.
    c. Assess the ability of elected officials to effectively manage people.
    d. Evaluate efficiency and effectiveness.

13. Which of the following is not a typical external user of a government or not-for-profit financial statements?
    a. Governing boards
    b. Securities and Exchange Commission
    c. Donors and grantors
    d. Taxpayers/citizens or organization members

14. Users of government financial statements should be interested in information about compliance with laws and regulations for which of the following reasons?
    a. To determine if the government has complied with bond covenants.
    b. To determine if the government has complied with taxing limitations.
    c. To determine if the government has complied with donor restrictions on the use of funds.
    d. To determine all of the above.

15. Which of the following is not generally considered a main user of government and not-for-profit entity external financial statements?
    a. Investors and creditors.
    b. Taxpayers.
    c. Donors.
    d. Internal managers.

16. Which of the following is a probable use an individual donor would make of the external financial statements of a not-for-profit entity?
    a. To determine the proportion of entity resources directed to programs as opposed to fund-raising.
    b. To determine the creditworthiness of the entity for investment purposes.
    c. To determine the salaries paid to all employees of the entity.
    d. To determine the budget of the entity.



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17. A regulatory agency would use the external financial statements of a local government for which of the following purposes?
    a. To ensure that the entity is spending and receiving resources in accordance with laws, regulations or policies.
    b. To determine how resources should be allocated.
    c. To exercise general oversight responsibility.
    d. To do all of the above.

18. A primary tool of both governments and not-for-profit to acquire funds to finance long-term projects is _____
    a. Levy of special purpose tax.
    b. Have a city-wide gala.
    c. Obtain line of credit on current assets.
    d. Issue bonds to individuals and institutional investors.

19. Which of the following objectives is considered the cornerstone of financial reporting by a state or local government?
    a. Accountability.
    b. Budgetary compliance.
    c. Interperiod equity.
    d. Service efforts and accomplishments.

20. Which of the following are objectives of financial reporting by state and local governments as established by the GASB?
    i. Accountability
    ii. Evaluation of legislative results
    iii. Level of service and ability to meet obligations

    a. I only
    b. II only
    c. I and III
    d. I, II and III
    e. III only

21. Which of the following is an objective of financial reporting by nongovernmental not-for-profit entities as established by the FASB?
    a. Assessing the types of services provided and the need for those services.
    b. Assessing the services provided and the entity's ability to earn a profit.
    c. Making rational decisions about the allocation of resources to those organizations.
    d. Assessing how managers have managed personnel.



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22. As used by the GASB, interperiod equity refers to which of the following?
    a. Compliance with finance-related contractual requirements.
    b. Whether the constituents pay for what they receive.
    c. Whether resources were obtained and used in accordance with the government's legally adopted budget.
    d. Assessing the government's economy, efficiency, and effectiveness.

23. Given a specific set of data, the basis of accounting selected by or imposed on a government will impact which of the following the least?
    a. Determining whether the government has a balanced budget.
    b. Determining whether the government has the ability to issue debt.
    c. Determining whether certain economic events occurred.
    d. Determining the annual payments to a government-sponsored pension plan.

24. The basis of accounting selected by or imposed on a government can influence which of the following?
    a. A decision to contract-out a specific service rather than provide that service itself.
    b. The amount of annual contribution to keep pension fully funded.
    c. The amount that is available to spend on a donor-specified project or service.
    d. All of the above.

25. The Governmental Accounting Standards Board is the primary standard-setting body for:
    a. All governments.
    b. All state and local governments.
    c. All governments and all not-for-profit entities.
    d. All state and local governments and all not-for-profit entities.

26. Under certain circumstances a government might use standards established by which of the following standard-setting bodies?
    a. GASB.
    b. FASB.
    c. AICPA.
    d. All of the above.



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27. The primary standard-setting body for accounting and financial reporting by a state-supported college or university is:
    a. GASB.
    b. FASB.
    c. AICPA.
    d. All of the above.

28. Which of the following entities was a principal in creating the FASAB?
    a. U.S. Congress.
    b. Office of Management and Budget.
    c. Governmental Accounting Standards Board.
    d. Securities and Exchange Commission.

29. The purpose of the FASAB is to establish accounting standards for
    a. Not-for-profit entities.
    b. Federal government.
    c. All governments.
    d. Non-federal governments.



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**ANSWERS TO MULTIPLE CHOICE (CHAPTER 1)**

1. b
2. b
3. d
4. c
5. a
6. d
7. c
8. c
9. c
10. d
11. d
12. c
13. d
14. d
15. d
16. a
17. d
18. d
19. a
20. d
21. c
22. b
23. c
24. d
25. b
26. d
27. a
28. b
29. b



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**PROBLEMS (CHAPTER 1)**

1. Tulip County adopted a cash budget for FY2022 as follows. The County budget laws prohibit budgeting or operating at a deficit. During the year the County collected or spent the following amounts. Was the County in compliance with budget laws? Did the County accomplish the goal of interperiod equity? Explain your answers in detail.

| | Budgeted | Collected/Spent |
|---|---|---|
| Receipts from property tax collections | | |
| From the 2021 levy | $ 100,000 | $ -0- |
| From the 2022 levy | $1,000,000 | $ 900,000 |
| In advance for 2023 | $ 50,000 | $ -0- |
| Receipts from bonds issued | $ 500,000 | $ 500,000 |
| Borrowed from bank (due in 5 years) | $ -0- | $ 75,000 |
| Disbursements | | |
| Salaries and wages | $ 500,000 | $ 500,000 |
| Operating expenses | $ 200,000 | $ 275,000 |
| City Hall annex purchased | $ 500,000 | $ 500,000 |
| Payments on debt principal | $ 150,000 | $ 150,000 |
| Payments on interest | $ 50,000 | $ 50,000 |
| Pension contribution | $ 80,000 | $ -0- |

Explanations provided by the County for the differences between budget and actual are as follows. Property tax collections are down because the major industry in the community closed and many citizens are currently unemployed. Operating expenses are up because the only bridge over a river bisecting the County sustained damages by an uninsured motorist and had to be repaired immediately. The repair was not budgeted.



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2. Save-the-Birds (STB), a not-for-profit entity dedicated to acquiring and preserving habitat for upland birds, prepares financial statements in accordance with generally accepted accounting principles. Currently, standards require that a not-for-profit entity report virtually all contributions as revenue in the year received. During the current year STB received a donation of several hundred acres of prime habitat for upland birds. STB will require several hundred thousand dollars in additional donations in order to make the land completely suitable for the birds. Before embarking on its fund-raising campaign STB prepares financial statements which are summarized as follows.

| Statement of Financial Position (Balance Sheet) | |
|---|---|
| Cash | $ 8,000 |
| Supplies | $ 2,000 |
| Equipment (net of depreciation) | $ 5,000 |
| Land | $1,000,000 |
| Total Assets | $1,015,000 |
| | |
| Liabilities | $ 1,000 |
| Net Assets—Unrestricted | $ 14,000 |
| Net Assets—Restricted | $1,000,000 |
| Total Liabilities and Net Assets | $1,015,000 |

| Statement of Activities (Income Statement) | |
|---|---|
| Revenues | $1,030,000 |
| Expenses: | |
| Salaries | $ 30,000 |
| Change in Net Assets | $1,000,000 |

What difficulties, if any, will STB encounter in its new fund-raising drive? Knowing that the donation of the land accounted for $1,000,000 of the revenue reported by STB, do you think the financial statements present fairly the financial position and results of operations of this not-for-profit entity?



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3. Jasmine City prepares its budget on the cash basis and prepares its external financial statements on the accrual basis. From the following data prepare statements of activity (income statements) on both the cash basis and the accrual basis. Which statement best represents the results of operations of the City? Which statement best demonstrates compliance with laws and regulations? Which statement would you rather see? Which conveys the best information to the citizens of Jasmine City?

   The City levies taxes in the current year of $1 million. Of this amount $.9 million is collected during the current year, $.05 will be collected next year, and $.04 will be collected in the future. $.01 will never be collected. During the current year the City pays bills from prior periods $.06 million, bills of the current period $.8 million, and defers payment until future periods on bills that were received for services consumed during the current period $.1 million.



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4. Certain fiscal practices of governments promote interperiod equity while others do not. For the situations listed below, indicate whether interperiod equity is promoted or undermined. Why?
   a. Issuing 30-year serial bonds to finance the construction of capital assets with estimated 30-year lives.
   b. Paying for the pensions of retired employees out of resources provided by current-period taxpayers.
   c. Charging the cost of supplies as expenditures in the year in which they were used rather than when they were purchased.
   d. Issuing 30-year bonds to finance a portion of the current-period operating costs of a city's school system
   e. Charging payments of wages and salaries made in the first week of a new year to the previous fiscal year, the year in which the wages and salaries were earned.



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## ANSWERS TO PROBLEMS (CHAPTER 1)

1. The County adopted a cash budget that projected an operating surplus of $170,000; therefore, it was in compliance with the "budgeting" portion of budget laws. In addition, the County "balanced" its current period operations. Total inflows are $1,475,000 and total outflows are $1,475,000. The County was seriously affected by the closure of the major employer in town. The County compensated for the shortfall in property tax revenues by failing to make the pension contribution in the current period and by borrowing on a long-term note at the bank. Although one expenditure category exceeded the budgeted amount (operating expense was $75,000 more than budgeted), another was short by $80,000 (pension contributions). The County has probably complied with the budget laws that prohibit operating at a deficit (if deficit is defined as a cash deficit). It has probably not complied with the budget laws if the laws state that current revenues (not including borrowing) must be equal to or exceed current period costs.

   Interperiod equity is another issue. By failing to make the required pension contribution the County has passed on to future taxpayers costs that were associated with operations of the current period. Also, by borrowing at the bank the County has incurred obligations that must be borne by future taxpayers.

2. Save-the-Birds (STB) will be launching a major fund-raising drive with a financial statement that shows $1,030,000 in donations and only $30,000 in expenses. It may be difficult to explain to potential donors why the entity is conducting a fund-raising drive at the present time. The balance sheet should help STB explain why they need the additional monies. However, many people familiar with financial statements of for-profit entities may have difficulty understanding how an entity can generate a $1,000,000 'profit' and still need to be soliciting funds. The equity section shows Net Assets of $1,000,000. It may be difficult for readers to understand that this is not similar to Retained Earnings in for-profit entities. The distinction between unrestricted and restricted may be meaningless to the average reader. [**Note:** Students may react as readers—why do they need another fund-raising drive now? If so, they have failed to grasp an important issue for many not-for-profit entities.]

3. The financial statements of STB present fairly the financial position and results of operations of the entity. The financial statements do not tell the whole story. It will be necessary for STB to explain why they need the funds.Jasmine City financial statements would be as follows:

| **Cash Basis** | | **Accrual Basis** |
|---|---|---|
| $.9 million | Property tax receipts | |



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| | | |
|---|---|---|
| | Property tax revenues | $.99 million |
| (.06) million | Prior period expenses | |
| | Accrued expenses | (.1) million |
| (.8) million | Current expenses | (.8) million |
| $.04 million | "Net Income" | $.09 million |

The cash basis financial statement would best demonstrate compliance with the budget but the non-cash basis financial statement would best convey results of operations. As a citizen, I would like to see both because legal compliance is important to me but so are results of operations. It may take both statements to fully inform the public about operations. [**Note:** At this point students have not been exposed to 'modified accrual' accounting so they will not struggle with revenue recognition issues imbedded in this problem.]

4.

a. Promotes interperiod equity. Because the bonds are required to be repaid over the life of the capital assets, the cost of those assets is allocated to the periods over which taxpayers benefit from the use of the assets.
b. Undermines interperiod equity. The employee benefits costs—pension benefits—are paid by an entirely different generation of taxpayers—long after the employees earned the benefits by providing services.
c. Promotes interperiod equity. Although not particularly material, supplies do not benefit taxpayers until they are used to provide services. Reporting these as expenditures when purchased reports the cost in a different period from when the benefit is provided.
d. Undermines interperiod equity. Using debt to finance operating costs spreads the cost of providing services provided *in a single period* over the entire term of the long-term debt. Interest costs on the debt amplify the problem.
e. Promotes interperiod equity. Again, while possibly immaterial, reporting the cost of providing services—in the form of wages and salaries—in the period in which services were provided promotes interperiod equity.



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**ESSAY (CHAPTER 1)**

1. In the United States, educational services can be provided by federal government entities, by non-federal government entities, by not-for-profit entities, and by for-profit entities. Are the accounting and financial reporting standards the same for each of these entities? Should they be the same?

2. The Governmental Accounting Standards Board (GASB) stated that an objective of financial reporting is to measure interperiod equity, that is—"Financial reporting should provide information to determine whether current-year revenues were sufficient to pay for current-year services." What is your understanding of interperiod equity? What costs incurred in the current year should be paid for by the taxpayers of the current period? What costs incurred in the current year should be paid for by future taxpayers?

3. A not-for-profit entity raises funds to support specific programs, services, and activities. The recipients of the programs, services, and activities are frequently not the providers of the resources needed to deliver the programs, services, and activities. What information would donors to these not-for-profit entities be interested in seeing? What information would program beneficiaries be interested in seeing? Identify other users of the financial statements of a not-for-profit and the types of information in which they would be interested.

4. What is the significance—for financial reporting purposes—of the fact that neither not-for-profits nor governments have owners (stockholders)?

5. What are some of the definitional criteria that distinguish a state or local government from a not-for-profit entity?

6. How does the FASB influence generally accepted accounting principles for state and local governments?



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## ANSWERS TO ESSAY QUESTIONS (CHAPTER 1)

1. Accounting standards for educational institutions differ by the nature of the ownership. Public schools (K-12) are accounted for in the same way as state and local governments, as are public colleges and universities, theoretically. Private schools, colleges, and universities are accounted for using not-for-profit standards established by FASB. For-profit educational institutions would use the FASB rules for other for-profit entities.

Because these entities are all involved in delivering the same basic service—education—it would appear that they should have the same standards. However, public schools are subject to the same openness as other government activities. The citizens should have a voice in determining what services are offered through the schools and how those services are delivered. The budget process is the opportunity for the public to be heard and the adopted budget is a plan of action to which citizens can, and should, hold officials accountable. For-profit schools are organized to generate profits and should measure net income using full accrual accounting. Not-for-profit entities generate revenues from tuition and solicit contributions from the public, or a select group of the public. Donors to not-for-profit entities may be interested in different information than taxpayers are interested in.

[**Note:** Students will have differing opinions about the appropriateness of different accounting standards for educational institutions determined by ownership rather than by activity. The question is designed to solicit their thoughts.]

2. Interperiod equity means that the citizens of one time period should pay the costs of the goods and services consumed during that time period. Interperiod equity as an accounting concept means that the financial statements should measure the success of a governmental entity in accomplishing the goal of raising sufficient revenues to pay for the cost of services consumed during a period. However, interperiod equity is a policy decision, not an accounting decision.

To achieve interperiod equity, current-year taxpayers should cover the cost of current-year services. Everyone would agree that current period operating costs should be covered, including supplies and payroll costs. In addition, a portion of the cost of capital assets or other improvements, which benefit more than one period, should be considered in the equation. Finally, certain costs may not be paid until well into the future but arise from current operations. The government's employees *earn* many of these in the current period, including accumulating vacation benefits, pension benefits, and other postemployment benefits.



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Costs that should not be included in the current year measure of interperiod equity are costs that will benefit future periods—for example, the portion of the historical cost of capital assets that will be allocated over future periods.

3. Donors to not-for-profit (NFP) entities are probably interested in information about the costs incurred by the not-for-profit. Donors would be interested in comparing the cost incurred in delivering services by one entity compared to the cost incurred by another entity for delivering the same type of service. The amount spent on programs compared to the amount spent on fund-raising and general and administrative costs would be of interest to donors. Major donors should be very interested in the amounts spent on salaries to top NFP officials because major donors are, in effect, paying those salaries. Beneficiaries would be interested in the costs of delivering the goods and services and the success of the NFP in securing the funds necessary to continue to deliver those goods and services.

   Regulatory agencies, such as the IRS, would be very interested in the financial information of NFP entities to assess whether they should continue to be considered a NFP entity. Governments would be interested in the financial information of NFP entities. Many governments are considering outsourcing or privatizing the delivery of goods and services. If other entities can, indeed, perform those services more efficiently than government, perhaps the services should be privatized or outsourced.

4. The obvious significance of the fact that neither not-for-profits nor governments have owners is that neither governments nor not-for-profits report owner's equity. More important however, is the fact that financial reports of governments cannot focus on owners. They must be prepared from the perspective of parties other than stockholders. Generally this focus is on resource providers and the restrictions they place on the assets they contribute.

   In addition, this distinction often means that there is less interest in the fair market values of assets and liabilities and other accounting measures that rely on fair values, such as pension expense. No stockholders exist to consider the price/earnings ratios of these entities or a potential buyout/takeover.

   Finally, both the FASB and the GASB have called for information on service efforts and accomplishments. These measures would be used to assess, among other things, how effectively and efficiently the entities provide services. This information, however, is not easily expressed in monetary measures and has not yet been included in financial statements.

5. First, and foremost, state and local governments usually have the power to assess taxes. Not-for-profit entities do not. In addition, governments may



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issue tax-exempt debt and their governing bodies are either elected by taxpayers or appointed by another government. Less common is the fact that a government can usually be unilaterally dissolved by another government (usually the one that created it) and its assets assumed without compensation. None of these things is true about not-for-profit entities.

6. The FASB influences generally accepted accounting principles of state and local governments in two key ways. First, FASB pronouncements are included in the GASB "hierarchy" of GAAP. FASB pronouncements that the GASB has specifically made applicable to governments are included in the highest category; those that the GASB has not specifically adopted are included in the lowest category. Second, the business-type activities of governments are required (with a few exceptions) to follow the business accounting principles as set forth by the FASB.



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