

GOVERNMENT ACCOUNTING

A Conceptual Approach

Government accounting presents several challenges to the newcomer more used to for-profit accounting. First, there are two reporting systems. These might be likened to a company having to produce reports based on both its managerial and its financial reporting system. Governments are required to do their internal accounting using *fund* accounting. They are required to publish reports that reflect the use of fund accounting. In addition, they are required to publish so-called *government-wide* reports that look much more like for-profit statements. It is very important, therefore, to know at which set of statements one is looking.

Second, governments are *legally* responsible for the flow of *financial* resources through the system. They levy and collect taxes, which are then spent in accordance with a budget established by the legislature, be it City Council, or House of Representatives. They must report back to taxpayers how that money was collected and how it was spent. They are much less concerned with measuring the flow of *economic* resources i.e., with recognizing revenue and matching it with expenses for the simple reason that they are not-for-profit entities and, therefore, have no mandate to measure the profit they make.

Third, governments do not have a capital account -- or a retained earnings account. They have asset and liability accounts that are virtually identical to for-profits. (One change is that the familiar accounts payable becomes vouchers payable!) The difference between the two is known as the *fund balance*. Some of this balance might have been earmarked or *encumbered* in previous years for spending in this year. If so, it is labeled encumbered fund as distinct from unencumbered or unreserved.

Fourth, like all other nonprofits but unlike for-profits, governments have a wide variety of revenue sources such as income taxes, property taxes, grants and so on. Apart from the multiple revenue sources, the *statement of changes in the fund balance* is virtually identical to an income statement with excess (or deficit) of revenues over expenditures replacing net income and net change in fund balance replacing change in retained earnings.

This short summary of government accounting begins with fund accounting and describes how it makes use of *modified accrual basis* for accounting. That is followed by a discussion of the government-wide reporting requirements of *GASB 34*.

FUND ACCOUNTING

The primary unit of analysis is the *reporting entity*, which may be a city, a parks board, a state government. Within that entity, there might be a number of components. The reporting entity is defined by the political structure. For instance, a city might be responsible for the water supply, the police department, and the fire department. These components are a part of the reporting entity if the entity (a) is able to impose its will on the component by legislation or election of its