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Government Accounting

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What is accounting?

- Accounting is the process of recording all financial transactions—revenues, expenditures, assets, liabilities—according to clear and usually precise rules, in such a manner that all transactions can be audited independently.
- "…analyzing, recording, summarizing, evaluating, and interpreting an organization's financial activities and status, and communicating the results".

Purposes of Accounting

- Maintains honesty, helping deter fraud and corruption and prevent inadvertent losses.
- Prevents expenditures from straying beyond legal parameters.
- Provides complete, timely, and accurate information concerning receipts and expenditures
- Reports on funds held in trust.
- Helps managers increase efficiency and effectiveness by providing historical financial information and identifying areas of waste.
- Communicates results to citizens.
- Identifies financial condition or the relative fiscal health of governments.

Organizational Responsibilities and Standards

- Federal accounting organizations:
  - Both Government Accountability Office (GAO) and Office of Management and Budget (OMB) set guidelines for federal agencies' accounting and financial management practices.
  - Federal Accounting Standards Advisory Board (FASAB) develop consensus on account standards to be adopted by GAO, OMB, and the Treasury Department.
- State and Local Organizations
  - Governmental Accounting Standards Board (GASB) sets professional standards for accounting and financial reporting for state and local governments.
  - State legislatures, state auditors and comptrollers set standards for their state and local systems.
  - GFOA issues policy guidelines for best practices.
- Private Sector Organizations: Financial Accounting Standards Board (FASB)
- Standards for State and Locals by GASB: Generally accepted accounting principles (GAAP)

Fund Accounting

- State and local governments separate financial resources into distinct accounting entities called funds. Each fund is set up to record and account for the use of a specific group of assets or sources of revenue.
- Three categories—governmental funds, proprietary funds, fiduciary funds
- Governmental funds include:
  - General fund: the largest fund, used for general purposes and funded by major taxes such as property tax and sales tax.
  - Special revenue funds: receive revenues from specific sources and are earmarked for specific purposes (such as gasoline taxes for transportation facilities).
  - Capital projects fund: used for the construction of capital projects such as buildings.
  - Debt service funds: used to pay interest and principal on government debt.
  - Permanent funds: only the interest or earnings from the fund, not the principal, can be spent, similar to an endowment fund.

Fund Accounting (cont)

- Proprietary funds include:
  - Enterprise funds: operate like private-sector businesses, charging customers for services provided.
  - Internal service funds: operate like businesses but provide services primarily to other government departments or agencies.
- Fiduciary funds include:
  - Pension trust funds: manage and administer pension benefits for government employees.
  - Investment trust funds: hold and manage investments on behalf of external entities.
  - Agency funds (custodial funds): hold and manage funds temporarily for other governments or entities.
  - Private-purpose trust funds: hold resources in trust for specific individuals, organizations, or groups (e.g., scholarship or employee benefit funds).

Structure and Rules of Accounting Systems

- Ledgers are used to organize and record the status of revenues, expenditures, assets, and liabilities.
- Accounting formula: Assets = liabilities + fund balance
- Accounting concepts:
  - Assets: Money or other resources owned by the organization.
  - Liabilities: Obligations the organization owes to others.
  - Fund balance: The difference between assets and liabilities; the organization's net resources.
- Example: House ($600,000) = Remaining Mortgage ($400,000) + Home Equity ($200,000)
- Inflows: acquisition of resources.
- Outflows: consumption of resources.

Classification of Receipts and Expenditures

- Receipts
  - Segregated by source, such as property taxes, sales taxes, income taxes, user fees, and other revenues.
- Expenditures can be categories in different ways
  - By fund and appropriation: e.g., general fund, special revenue funds, appropriations.
  - By organizational unit: e.g., Department of Education, Department of Health.
  - By object of expenditure: e.g., personnel and benefits, contracts, supplies.
  - Expenditures may also be further divided into sub-objects or subcategories.
- Example: NYS OSC accounting manual for local governments https://www.osc.ny.gov/files/local-government/publications/pdf/arm.pdf

Basis of Accounting

The basis of accounting refers to the timing of when financial transactions are recorded (i.e., when revenues and expenditures are recognized).

Major bases of accounting include:

- Cash basis: Transactions are recognized when cash is received or paid.
- Encumbrance accounting: Expenditures are recognized when funds are committed or obligations are made (commonly used for budget control).
- Accrual basis: Transactions are recognized when the economic activity occurs, regardless of when cash is received or paid.
- Modified accrual basis:
  - Revenues are recognized when they are measurable and available.
  - Expenditures are recorded when the obligation to spend has occurred.

Public Pension plans

- State and local pension plans represent major future liabilities for governments.
- A common type is the defined benefit plan, where retirement benefits are determined by factors such as years of service, final salary, and a benefit multiplier.
- Pension systems may be funded through pay-as-you-go financing or advance (pre) funding. Most defined benefit plans use advance funding, though funding gaps often remain.
- Many governments have increasingly adopted defined contribution plans, similar to 401(k) plans in the private sector. In these plans, the contribution is fixed, but the retirement benefit depends on investment performance.
- State and local governments also face substantial unfunded liabilities for pensions and retiree health benefits, often called Other Post-Employment Benefits (OPEB).

Financial Reporting

- GASB establishes standards for government financial reporting. Many governments prepare Annual Comprehensive Financial Reports (ACFRs).
- Balance sheets
  - Present the government's financial position (assets, liabilities, and fund balances) at a specific point in time.
- Operating statements
  - Show revenues, expenditures, and surplus or deficit during a fiscal year.
- Cash flow statements
  - Report cash inflows and outflows.
  - Primarily used for proprietary funds.
- Example: Albany County Financial Statements

Governmental Auditing

- Governments are audited according to Generally Accepted Auditing Standards (GAAS).
- Governments often engage private auditing firms to conduct audits.
- In some cases, audits are conducted by independent government audit offices or officials.
- Audits can be financial audits or program (performance) audits:
  - Financial audits assess whether financial statements accurately present financial transactions and the government's financial position.
  - Performance (program) audits evaluate whether resources are used efficiently, effectively, and in accordance with objectives.