

## TEACHING IDEAS FOR THE COMMENCEMENT OF THE GOVERNMENTAL ACCOUNTING COURSE

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*Abstract:* Many undergraduate accounting students enter their first course in governmental accounting with a negative attitude about the subject. This is due, in part, to the fact that after several courses in "accounting," the governmental course presents methods and procedures which are quite different and are, therefore, suspect. This paper encourages an approach to the course which can overcome this bias by providing an appropriate context from which to commence the course.

The importance of accounting and auditing in the public sector is at an all-time high. The fiscal stress of a number of cities, the "tax-lid" bills passed by voters in many states, the audit requirements of revenue-sharing type plans, and the general desire of citizens for a higher degree of accountability over their tax dollars have all contributed to this interest. These factors, combined with the announcement that at least 10% of the theory and practice sections of future CPA examinations would be devoted to questions over the area, have resulted in an increased demand for undergraduate courses in public sector accounting.

Accounting students who take a governmental course often do so during the final year of their undergraduate program. At this point they usually will have completed between five and seven courses in accounting. Each of these courses, whether in the financial, managerial, or tax areas of accounting will have emphasized the full-accrual type accounting of the private sector. Each course may well have introduced new rules owing to different objectives, but all will have debited an asset account when a building was purchased and credited a liability account when bonds were issued. Having thus learned what "accounting" is, it is not surprising that, when faced with methods that debit an expense-like account when a building is purchased and which credit a revenue-like account when bonds are issued, students question these methods.

It is important, then, that *before* students are exposed to these methods, they understand how and why the methods have developed as they have. The purpose of this paper is to illustrate a convenient way to demonstrate that (1) accounting procedures in the public sector evolved in much the same manner and over the same period of time as did the procedures used in the private sector, (2) the procedures used in the two sectors of the economy are different for very good reasons, and (3) some of the procedures used in the public sector might be applied to some advantage by accountants in the private sector.

## THE DEVELOPMENT OF ACCOUNTING PRINCIPLES

First, it is useful to compare and contrast the development of accounting principles in the public sector with those in the private sector. Table 1 illustrates a convenient way to do this. Table 1 demonstrates that principles in both sectors grew from a common root, but emphasizes that each sector branched out in response to different environmental stimuli. It further makes clear that although similar, the branches have been distinct for over 50 years. The events and the time-frame depicted in Table 1 are arbitrary; however recall that the purpose here is not to review history, but is to suggest a context for the study of governmental accounting.

Prior to 1900 the country was generally non-urban and non-industrial and accounting in both the private and public sectors lacked sophistication. The industrial revolution brought about a move to the corporate form of organization and also a migration of the population to cities. Just as absentee owners demanded accountability over assets entrusted to corporate managers, so too did citizens demand an accounting from the management of government units. Should the two types of entities require the same or different accounting models?

For the first 30 years of the 20th century this question was debated. Frederick Metz, Controller of New York City, advocated use of the same model. In 1913 he issued the *Metz Handbook* which illustrated how private sector procedures could be used by a city. F. A. Cleveland wrote several articles during the period in support of the Metz position. In 1921 the forerunner of the Brookings Institute commissioned and published a study by Francis Oakey which was the first statement of the fund model. This was followed in 1927 by a governmental accounting textbook authored by Lloyd Morey of the University of Illinois. Morey's text utilized the fund model and effectively signaled the end of the debate. For the next 50 years accounting principles in the two sectors were established separately but in a remarkably similar fashion.

In the private sector, public accountants, through their organization the American Institute of Certified Public Accountants (AICPA), acted as the catalyst for the setting of principles. This was done, first, through the Committee on Accounting Procedures, then the Accounting Principles Board, and most recently the Financial Accounting Standards Board (FASB). Although the FASB has taken steps to ensure at least "quasi-independence," and although the names have changed, the process has remained essentially one of standard setting by CPAs for CPAs.

Likewise, peer-group standard setting is also the method which has been employed in the public sector. The organization representing practicing accountants in the governmental sector is known as the Government (formerly Municipal) Finance Officers Association (GFOA). Under the auspices of the MFOA, first the National Committee on Municipal Accounting (NCMA), then the National Committee on Governmental Accounting

TABLE 1

Selected Events in the Development of Accounting Principles

	1899	- The National Municipal League drafted the model Municipal Corporation Act which included model financial statements	
	1900		
	1901		
	1902		
F. A. Cleveland publishes first in a series of articles advocating that cities adopt corporate accounting methods	1903		
	1904		
	1905		
	1906		
Sprague's <i>The Philosophy of Accounts</i> is published	1907	- New York Bureau of Municipal Research issues first report "Making A Budget," Minnesota first state to require financial statements of counties, Federal Government changes to double entry method of accounting	
	1908		
	1909		
	1910		
	1911		
	1912		
Paton's <i>Accounting Theory</i> is published	1913	- The <i>Metz Handbook</i> is published advocating and illustrating the use of private sector accounting in governmental units	
	1914		
	1921	- The Institute for Governmental Research publishes Francis Oakey's <i>Principles of Governmental Accounting and Reporting</i> which is the first statement of the fund model of accounting for government	
Lloyd Morey's <i>Introduction to Governmental Accounting</i> is published (fund model)	1922		
	1927		
1933	- SEC Requires Accounting Reports for all traded companies		1933
1934	The SEC decides to allow the accounting profession to lead way in standard setting, the Committee on Accounting Procedures is formed (CAP)	The National Committee on Municipal Accounting is formed and releases "Principles of Municipal Accounting" (fund model)	1934
1935			1935
1936	- American Institute of Accountants issues <i>Examination of Financial Statements by Independent Public Accountants</i>	The NCMA Issues "Municipal Funds and Their Balance Sheets"	1936
1937			1937
1938	- Sanders, Hatfield & Moore's <i>A Statement of Accounting Principles</i> is published		1938
1939			1939
1940	- ARB Number 1 is issued		1940
1951	Paton and Littleton's <i>An Introduction to Corporate Accounting Standards</i> is issued	The MFOA publishes <i>Municipal Accounting and Auditing</i> , the "Blue Book"	1951
1952			1952
1953	Accounting Terminology Bulletin Number 1 issued	The MFOA publishes <i>Standard Classification of Municipal Accounts</i> , the "Red Book"	1953
1959	The Accounting Principles Board supercedes CAP (51 ARBS were issued)		1959
1968		The MFOA publishes the updated and retitled Blue Book <i>Governmental Accounting Auditing and Financial Reporting</i> (GAAFR)	1968
1969			1969
1970			1970
1971		The AAA publishes "The Report of The Committee on Accounting Practices of NFP Organizations"	1971
1972			1972
1973	The Financial Accounting Standards Board (FASB) supercedes the APB (31 Opinions and 4 Statements were issued)		1973
1974		The National Council on Governmental Accounting supercedes the NCGA	1974
1975			1975
1976	The AICPA issues <i>Audits of State and Local Governments</i> which endorses GAAFR as GAAP		1976
1977	New York City Defaults on its bonds		1977
1978	Several studies issued which are critical of accounting in the public sector. Senator Williams proposes that the federal government set accounting standards for state and local governments		1978
1979			1979
1980		The NCGA issues Statement 1	1980
1981	Statement of Position 80-2 accepts Statement 1	The MFOA issues updated GAAFR	1981
1982	The Governmental Accounting Standards Board (GASB) Organization Committee is formed		1982
1983	GASBOC issues an exposure draft		1983
1984	THE GASB is established. GASB accepts as authoritative all NCGA pronouncements still in effect and AICPA Industry Audit Guide		1984

(NCGA), and finally the National Council on Governmental Accounting (NCGA) were formed and functioned as standard setters.

## COMPARING THE TWO SECTORS

Given that the *process* in the two sectors has been similar, how is it that the procedures that evolved are so vastly different? As summarized in Table 2, it really could not have been otherwise. First, the objective of an organization in the private sector is capital growth through profit. Without reviewing the myriad of complications involved, the essence of “profit” is revenues minus expenses, and hence the matching principle. Contrast this with an organization in the public sector whose objective not only is not capital growth, but may in fact be capital expenditure. There is no matching principle; the receipt of services has no direct relationship with the payment for those services. Instead, the appropriation process creates a demand for a “spendable resources” measurement focus rather than a “matching of costs with benefits” focus.

Second, the stated beneficiary of standards in the private sector is the unknown third party who may wish to evaluate the entity in question. Consider that the opposite of an “unknown third party” is management—and it is management that is one beneficiary of standards in the public sector. The desire of management is to be able to demonstrate effective stewardship over the public resources with which they have been entrusted. Hence a major objective of the accounting procedures is to allow measurement of compliance with budgets, grants, and other legal requirements.<sup>1</sup>

**TABLE 2**

### The Development of Accounting Principles

	In the Private Sector	In the Public Sector
Directed by	Public accountants through their organization the AICPA (until the quasi-independent FASB in 1973)	Municipal accountants through their organization the MFOA (now GFOA) (until the NCGA issued Statement 1 in 1979)
Intended beneficiary of principles	Unknown third parties such as creditors	The management of the entity
Intended result of applying principles	Evaluation of the performance of the entity	Demonstration of compliance and control
Measurement objective	Net income	Accountability

<sup>1</sup>GAAPF identified public managers as a “primary” beneficiary. *Statement 1* declares that compliance reporting is an “important function” of governmental accounting systems. The measurement focus has been recently expanded to also include the notions of efficiency and effectiveness.

Thus, virtually since the inception of standard setting by the accounting profession, standards have been set independently in the two sectors. The respective standards evolved in response to different problems stemming from different objectives and were set by different groups. It is really not surprising that the standards are different. But notice that "different" does not suggest "better" or "worse." This fact was implicitly recognized by the absence of concern in either sector for the standards in the other sector for more than 50 years. None of the various ARBs, APBs or FASB pronouncements were required for governmental entities. Conversely, GAAFR did not apply to entities in the private sector.

Responding to the fact that public accountants were being requested to provide increasing amounts of services in governmental entities, the AICPA, in 1974, issued an audit guide which recognized GAAFR as "generally accepted" for state and local governmental entities. Unfortunately, shortly after this audit guide was issued, New York City's much publicized fiscal crisis occurred. When it was discovered that New York City had poor accounting records, a series of studies [e.g., Coopers & Lybrand, 1976 and Davidson, et al., 1977] were issued which identified the standards in the governmental sector (or the lack thereof) as the reason. What these studies failed to acknowledge was that New York City was not following *any* standards, governmental or otherwise.

In the several years since the New York City crisis precipitated this debate, a number of suggestions regarding the standard setting process have been discussed. The culmination of this process is the recently approved Governmental Accounting Standards Board (GASB) equal in status with the FASB. Both Boards answer to a single oversight body, the Financial Accounting Foundation (FAF). Thus, it seems clear that the methods and procedures of accounting which have evolved in the public sector will remain intact for the simple reason that, although not perfect for all purposes, they do allow the accomplishment of a number of worthwhile objectives.

After reviewing the development of standards in the public sector and comparing it with the development in the private sector, and after establishing that the differences that exist between methods in the two sectors are unavoidable given the differing objectives of the two sectors, a final exercise is helpful before proceeding to the procedures themselves.

## THE EXCHANGE OF IDEAS BETWEEN THE TWO SECTORS

Given that the methods which have evolved in the two sectors are different, perhaps selected ideas and procedures used in one sector would be useful in the other sector. For example, municipal financial reporting has incorporated some commercial accounting concepts such as combined overview statements, liftable general purpose statements, segment reporting for enterprise funds, and greater emphasis on disclosure of "off-balance sheet" items such as

leases. Are there governmental accounting procedures or ideas which would be useful in the private sector?

Since the student will not be aware of the procedures used by governmental entities, this notion should only be suggested at this point. As an example of the discussions which might come later, however, the students can be asked to consider the matter of depreciation. Entities in the private sector take depreciation in keeping with the matching principle. Governmental units normally do not take depreciation, but instead "expense" the asset in the year of purchase. Remind the students that when making many decisions (for instance whether or not to buy a new machine) they have been told to ignore the cost of previously purchased assets as a "sunk cost" and therefore irrelevant to the decision. Is it possible that in taking depreciation, which is irrelevant for some decision purposes, financial accountants actually hinder decision-making? Could it be that entities in the private sector could improve the relevance of their financial statements for decision-making purposes by eliminating depreciation?

As a second example of the potential relevance of governmental accounting procedures to private-sector accounting, the use of budgetary accounting and reporting may be cited. Several writers in the private sector have suggested that budgetary disclosure would provide investors with valuable information about management's performance and about their plans for the future (e.g., Cooper, et al., 1968; Horngren, 1980). Governmental accountants have long recognized the importance of reporting comparisons of budget to actual results and have made budgetary entries a formal part of the accounting process. Perhaps there are other ideas which might be adopted as well. If the students are willing to concede this as a possibility, they are ready to *begin* the study of governmental accounting.

## SUMMARY

This paper has suggested an approach to the teaching of a governmental accounting course which involves reviewing how (Table 1) and why (Table 2) governmental standards and procedures came to be different than those in the private sector and to encourage the student to keep an open mind when examining the differences. The classroom time over which the ideas expressed in this paper should be developed will vary depending on several factors; however the teacher should find that the time involved will return proportional dividends in the form of more receptive students.

## REFERENCES

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