

# Chapter 4

## Generally Accepted Accounting Principles (GAAP)

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### INTRODUCTION

This chapter discusses Generally Accepted Accounting Principles (GAAP) as they apply to governments and private nonprofit organizations, the most common recipients and subrecipients of WtW funds. The issues discussed in this chapter are complicated, and there are many exceptions to the rule. Before an entity or organization makes any significant change in its accounting system, it should discuss this change with a Certified Public Accountant or its auditor.

This chapter contains the following sections:

- What is GAAP?
- GAAP Authoritative Bodies
- Basic Concepts and Principles
- Additional Governmental GAAP Principles
- Additional GAAP Principles for Nonprofit Organizations
- References.

### WHAT IS GAAP?

OMB circulars A-87 and A-122, which establish principles and procedures for determining allowable costs, use the term “generally accepted accounting principles” (“GAAP”) to describe the accounting rules and procedures that have evolved through custom and common usage and are now recognized by authoritative bodies or conventions (such as the American Institute of Certified Public Accountants (AICPA) or Governmental Accounting Standards Board (GASB)).

The central theme of GAAP is accountability. GAAP is intended to provide minimum standards, guidelines, and policy for financial accounting and reporting. GAAP ensures that a reader of financial information will be reviewing financial data and reports that are consistent, comparable, and present fairly the financial results of an organization.

GAAP varies by type of organization. Whether a government, educational agency, private nonprofit, or for-profit (commercial) organization, each entity is involved in different activities for generating revenues (taxes vs. tuition), has different legal requirements (funds must be appropriated and encumbered vs. only budgeted), or can account for specific items in more than

one way (inventories being capitalized or directly expended). The framework and structure of the accounting system also varies, such as a fund accounting vs. a standard full accrual accounting system. However, among similar types of entities or organizations, the GAAP requirements are the same.

## **GAAP AUTHORITATIVE BODIES**

Two authoritative bodies establish accounting principles and reporting standards applicable to WtW recipients and subrecipients:

- GASB for State and local governments
- Financial Accounting Standards Board (FASB) for nongovernmental entities.

Specific accounting principles also result from actions by regulatory agencies, as well as State and local laws. In addition, other accounting literature such as policy interpretations, opinions, guides, and textbooks have, over time, become generally accepted.

The chart on the next page shows the nongovernmental and governmental accounting hierarchy established by the AICPA Statement on Auditing Standards (SAS) Number 69. The hierarchy, shown on the following page, has five levels of authority, and each level is subordinate to the level(s) directly above it. Thus, if an accounting issue is addressed on more than one level, the highest level must be followed for the particular accounting issue.

# GAAP Hierarchy

## Established Accounting Principles

### Nongovernmental Entities

#### **FASB Statements and Interpretations**

- ◆ APB Opinions
- ◆ AICPA Accounting Research Bulletins



#### **FASB Technical Bulletins**

- ◆ AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position



#### **Consensus Positions of the FASB Emerging Issues Task Force**

- ◆ AICPA Practice Bulletins



#### **AICPA Accounting Interpretations, “Q’s and A’s” Published by the FASB**

- ◆ Industry practices widely recognized and prevalent



#### **Other Accounting Literature\*\***

- ◆ FASB + GASB Concept Statements
- ◆ APB Statements
- ◆ AICPA Issue Papers
- ◆ International Accounting Standards Committee Statements
- ◆ GASB Statements, Interpretations, and Technical Bulletins
- ◆ Pronouncements of other professional associations or regulatory agencies
- ◆ AICPA Technical Practice Aids and accounting textbooks, handbooks, and articles

### State and Local Governments

#### **GASB Statements and Interpretations**

- ◆ AICPA and FASB pronouncements if made applicable to State and local governments by a GASB Statement or Interpretation



#### **GASB Technical Bulletins**

- ◆ These pronouncements if specifically made applicable to State and local governments by the AICPA: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position



#### **Consensus Positions of the GASB Emerging Issues Task Force**

- ◆ AICPA Practice Bulletins if specifically made applicable to State and local governments by the AICPA



#### **“Q’s and A’s” Published by the GASB Staff**

- ◆ Industry practices widely recognized and prevalent



#### **Other Accounting Literature\*\***

- ◆ GASB Concept Statements
- ◆ Pronouncements in the Established Accounting Principles category for nongovernmental entities when not specifically made applicable to State and local governments
- ◆ APB Statements
- ◆ FASB Concept Statements
- ◆ AICPA Issue Papers
- ◆ International Accounting Standards Committee Statements
- ◆ Pronouncements of other professional associations or regulatory agencies
- ◆ AICPA Technical Practice Aids, accounting books, handbooks, and articles

\*\* In the absence of established accounting principles, the auditor may consider other accounting literature, depending on its relevance to the circumstances.

## **BASIC CONCEPTS AND PRINCIPLES**

GAAP includes some basic concepts and principles that apply to all entities, financial systems, and financial reporting requirements. These principles are also embodied in OMB Circulars A-87 and A-122 and reflected in the standards for financial systems found at 29 CFR 97.20 and 29 CFR 95.21, and are discussed below.

### **Detailed Information to Account for Awards and Obligations**

The financial accounting and reporting system shall contain sufficient detailed information to accurately account for subgrant and contract awards, obligations, unobligated balances, assets, liabilities, expenditures, and income.

### **Consistent Treatment of Information**

Financial transactions and data should be treated consistently.

### **Fair Presentation/Full Disclosure**

The system should present fairly and disclose fully the financial position and results of the entity's or organization's operation.

### **Conformance with Legal and Contractual Provisions**

The system ensures compliance with legal and contractual provisions and with the entity's or organization's fiduciary responsibilities.

### **Matching Revenues with Related Expenses**

Revenues are matched with related expenses for the same time period. Revenues are recorded when earned, and expenses are recorded when incurred. Grants are generally recognized as revenues when the actual expenditures financed by the grants are incurred. Miscellaneous revenues (program income/interest) should be recognized when received.

### **Fund Accounting on a Fund Basis**

The accounting system should be established on a fund basis. A fund is a self-balancing set of accounts, recording all assets, related liabilities, and fund balances. Governmental units may use all of the following funds and account groups and, for some types of funds such as Special Revenue Funds, may have several separate funds. However, nonprofits usually have only a General Fund (unrestricted); Endowment Fund(s), Custodial Fund(s), and/or Current Restricted Fund(s) (similar to Special Revenue Funds); and a Plant Fund (similar to the General Fixed Assets Account Group). An entity or organization should establish only those funds necessary to meet its accounting and reporting needs. For WtW, there is a minimum of one fund per appropriation year.

## Governmental Funds

- # **General Funds** account for all financial resources except those required to be accounted for in another fund. These would include State-appropriated money to support training programs from general revenues. In some cases, it may be possible to account for funds that would usually be in a Special Revenue Fund in the General Fund, and still meet imposed legal requirements. A Special Revenue Fund would be required only if specifically stated in the law. Neither the WtW statute nor regulations require accounting for WtW grants in a Special Revenue Fund.
- # **Special Revenue Funds** account for funds from specific revenue sources, such as WtW, that are legally restricted to expenditures for specific purposes. Some States may require special revenue accounts that provide authority for WtW recipients to receive, deposit, and expend funds resulting from operating the Federal programs. A Special Revenue Fund is not required if all legal requirements can be met by accounting for the funds in the General Fund.
- # **Capital Projects Funds** account for funds to be used for the acquisition or construction of major capital facilities, but not if financed by Proprietary Funds, Special Assessment Funds, or Trust Funds. These are not applicable to WtW.
- # **Debt Service Funds** are for the accumulation of funds for paying general long-term debt. These are not applicable to WtW.

## Proprietary Funds

- # **Enterprise Funds** account for operations where the costs of providing goods or services to the general public are financed through user charges, or where periodic determinations of revenues, expenses, and net income are appropriate for public policy purposes. An example would be a municipally-owned public golf course.
- # **Internal Service Funds** account for the provision of goods and services by one department or agency to other departments, agencies, or governmental units on a cost-reimbursement basis or fee structure. This might include metered postal charges held directly by or shared with other units, or computer services obtained through a centralized data processing facility.

## Fiduciary Funds

- # **Trust and Agency Funds** account for assets held by an entity in a trustee capacity for individuals, private organizations, governmental units, or other funds. They include Expendable Trust Funds, Nonexpendable Trust Funds, Pension Trust Funds, and Agency Funds.

## **Fixed Assets and Long-Term Liabilities**

The accounting for fixed assets and long-term liabilities should clearly distinguish between fund fixed assets and long-term liabilities, and general fixed assets and long-term debt. All fixed assets not related to a specific fund(s) should be accounted for through the General Fixed Assets Account Group. All long-term liabilities not related to a specific fund(s) should be accounted for through the General Long-Term Debt Account Group.

## **Budgetary Control**

There should be appropriate budgetary control, and budgetary comparisons should be included in the financial statements and schedules. The WtW grant file should contain planning instructions, program design standards, applicable program planning and budgetary documents, all modifications, all comparisons between planned and actual performance, and required corrective actions during a program year, as well as periodic fiscal reports.

## **Common Terminology and Classification**

Terms and classifications should be used consistently throughout the financial accounting system, including the budget, the accounts, and the financial reports of each fund for the entity/organization.

## **Accrual and Modified Accrual Accounting**

Recipients are required to report their WtW financial results to DOL on an accrued expenditure basis. GAAP requires other nonprofit organizations (ONPOs) to use the accrual basis of accounting in measuring financial position and results of financial operations. Items (revenues and expenses) that can be accurately estimated are accrued. The modified accrual basis of accounting refers to a combination of accrual and cash accounting. If the items cannot be accurately estimated, then the cash basis of accounting and reporting is used. For WtW, modified accrual accounting also refers to cash basis accounting, with accruals calculated and recorded in the records or on worksheets for inclusion in required reports.

## **Interim and Comprehensive Annual Financial Reports**

Statements of financial position, operating results, cash flows, and other pertinent information and schedules should be prepared to facilitate management control of financial operations, external/legislative oversight, an entity's or organization's fiduciary responsibilities, and for external reporting purposes.

Recipients must ensure that funds are obligated and expended in a timely manner. Although WtW grantees must submit quarterly reports to the DOL, they may decide to require more frequent reports from subrecipients to ensure timely management oversight.

## **ADDITIONAL GOVERNMENTAL GAAP PRINCIPLES**

## **Management Responsibility to Its Citizens**

Managers of a governmental entity are responsible for their actions to the citizens whose interests they represent. It is essential that the financial accounting and reporting system provide adequate information to citizens so that they can evaluate the performance of those empowered to act on their behalf and determine the operating results of the governmental entity for the year, the level of services it provided, and the government entity's ability to meet its obligations when due.

## **Fixed Assets Accounted For at Cost**

If the cost cannot be reasonably determined, the asset should be accounted for at an estimated cost. Donated fixed assets should be recorded at their estimated fair market value at the time received.

## **Depreciation of Fixed Assets**

The depreciation of general fixed assets should be recorded in the General Fixed Assets Account Group. Fund accounts should be avoided because depreciation is recognized only in funds such as Trust or Proprietary Funds where expenses, net income, and capital maintenance are measured.

The proper accounting for and reporting of depreciation in governmental funds and account groups are complex issues and should be thoroughly reviewed. Accounting for and reporting of depreciation for WtW may differ from GAAP because of the actual ownership of the equipment. Also, fixed asset costs may not be allowable in most instances under WtW. In many cases, the acquisition of a capital asset would be recorded as an expenditure in the year of acquisition for WtW, but recorded and depreciated in the General Fixed Assets Account Group of the entity.

## **Transfers Classified Separately from Revenues and Expenditures**

Revenues and expenditures should be classified separately from any interfund transfer or such things as receipts from debts and bond issuances.

Fund revenues should be classified by fund and source, while expenditures should be classified by cost objective, which includes fund, function (or program), organization unit, activity, contract, grant, character, and principal classes of objects. Accounting for WtW should be organized accordingly, but at a minimum by type of cost (such as salaries, rent, and utilities), and, if applicable, by cost category.

Proprietary Funds are essentially business ventures. Revenues and expenses should be accounted for as a commercial business.

## **Differing GAAP and Legal Requirements**

An accounting system must accommodate GAAP principles as well as legal and contractual obligations. An entity's constitution, charter, or grant regulations may impose reporting requirements that differ from GAAP. GAAP may require that a transaction be accounted for on

an accrual basis, but the entity's legal basis may require that the cash method be used. For example, GAAP allows for the accrual of the liability/expense for compensated absences (annual and sick leave). However, many entities recognize the expense when the leave is taken, or restrict the amount of payments for leave or the number of days that may be accumulated. Any difference such as this between GAAP and the legal requirement would have to be disclosed in the financial statements.

## **ADDITIONAL GAAP PRINCIPLES FOR NONPROFIT ORGANIZATIONS**

For accounting purposes, nonprofits are categorized as:

- Colleges and universities
- Hospitals
- Voluntary health and welfare organizations
- ONPOs.

This section applies to ONPOs, which are nonprofits that do not fall into any of the other categories. Accounting and reporting guidelines for ONPOs are established in the AICPA publication titled *Audit and Accounting Guide, Not for Profit Organizations*, 1998.

Most accounting principles applicable to ONPOs are consistent with those used for commercial enterprises. Private nonprofits should use the accounting standards set by the FASB when the AICPA guides do not address the issue.

Other nonprofits such as certain schools, universities, and hospitals may be partially controlled by a government and are viewed as part of that governmental entity. These organizations should follow pronouncements set forth by the GASB when the issue is covered in the GASB pronouncements. The following paragraphs highlight issues related to private nonprofits that are not considered part of a government entity.

### **Fund Accounting in ONPOs Financial Reporting**

While not required, use of fund accounting is strongly recommended because it facilitates accountability for restricted resources such as grants. If a nonprofit decides not to use the fund structure, all material restrictions on resources must still be disclosed in the financial statements.

Unrestricted funds are used to account for financial resources that can be used for any purpose that has been approved by the organization's Board of Directors. Restricted funds are used to account for monies that are restricted by an external organization such as a grantor and can be used only for specific purposes. WtW funds would be accounted for as restricted funds.

### **Separate Funds Are Recommended to Account for WtW Grants**

The separate fund method is recommended because it enhances accountability and also provides for a fairly straightforward reconciliation between the financial statements and Federal reports

such as the WtW Quarterly Financial Status Report (QFSR).

Because a variety of organizations are classified as ONPOs, there is no specific list of funds that would be used. Generally, routine WtW grant transactions can be accounted for in operating funds (restricted and unrestricted) and a Plant Fund for fixed assets.

### **Budgetary Control Information**

DOL, in 29 CFR Part 95, requires recipients to compare planned versus actual expenditures. Although GAAP does not require ONPOs to integrate budget accounts into their formal accounting systems, they may choose to do so. The budget provides the basis for planning, control, and evaluation of the entity and each fund type. In a WtW organization, integration of budgetary accounts into the accounting system could provide a formal means for tracking and recording grant availability and carryover funds.

### **Classification of Resources**

Flows of resources should be categorized as revenues, support, and capital additions.

- # **Revenues.** Gross increases in assets, gross decreases in liabilities, or a combination of both from delivering or producing goods, rendering services, or other earning activities of an organization during a period.
- # **Support.** The conveyance of property from one person or organization to another without consideration, e.g., donations, gifts, or bequests.
- # **Capital Additions.** Gifts, grants, bequests, investment income, and gains and losses on investments, restricted either permanently or for a period of time by parties outside of the organization to Endowment and Loan Funds. Capital additions also include similar resources restricted for fixed assets additions, but only to the extent expended during the year. In accounting for WtW grants, grant revenues should be presented separately in the financial statements from other revenues such as fees for services.

Expenses should be classified on a functional and/or a natural (object) basis. Organizations that receive a significant amount of financial support from the general public should use the functional basis for financial statement presentation. A functional basis would have classifications for program services, management and general (administrative) costs, and fund-raising costs. Examples of categories in a natural classification include salaries, benefits, supplies, and rent. For WtW, cost categories such as administration and activities such as community services could be used as functional basis expenditure classifications.

### **Interim and Annual Financial Reports**

Under GAAP, ONPOs must issue three annual financial statements: the Statement of Financial Position, the Statement of Activities, and the Statement of Cash Flows. ONPOs may choose to issue one or more of these statements more frequently. Combined statements that include all

financially interrelated segments of the organization are preferable to single fund statements. DOL-required WTW financial reporting that is described in Chapter 8 of this TAG is in addition to and must be reconcilable with the GAAP-prescribed statements.

All ONPOs should obtain a copy of the AICPA *Audit and Accounting Guide, Not for Profit Organizations*.

## REFERENCES

American Institute of Certified Public Accountants (AICPA). *Audit and Accounting Guide, State and Local Governmental Units*, 1998.

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American Institute of Certified Public Accountants. *Audits of Colleges and Universities*, 1994.

American Institute of Certified Public Accountants. *Audits of Voluntary Health and Welfare Organizations*, 1994.

Delaney, Patrick R., *GAAP 99*, John Wiley & Sons, Inc., New York, 1999.

**Note: Many of these publications are updated and published each year. The AICPA publishes numerous audit and accounting guides and reference materials. For further information, call AICPA at 1-888-777-7077; Website: <http://www.aicpa.org>.**