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THE EVOLUTION AND CURRENT STATE OF FINANCIAL ACCOUNTING CONCEPTS AND STANDARDS IN THE NONBUSINESS SECTOR

Abstract: This article presents a condensed history of significant post 1900 developments in nonbusiness financial accounting practices and standards, and highlights some of the major issues in the recent increase in interest and activity in nonbusiness accounting. It includes consideration of federal, state, and local government units along with various types of nongovernmental nonbusiness entities. The initial section of the article traces both the development of fund accounting techniques and the discovery of their inadequacies. Next, the article discusses developments in standard-setting and the search for a sound theoretical foundation. Finally, it presents a current profile of nonbusiness accounting. The article implies that nonbusiness accounting can no longer be treated as a secondary consideration. The nonbusiness sector is a major component of the environment that requires sound financial accounting and reporting standards and practices.

Introduction

During the past decade there has been an accelerating intensity in the study of accounting and financial reporting standards for not-for-profit entities. The current interest represents a change from the past when (1) only secondary importance was accorded these entities by financial accounting standard-setting bodies, and (2) standard-setting for such entities was completely separate from standard-setting for profit oriented entities. These changes came naturally as larger amounts of resources were channeled to not-for-profit entities.

This article contains three sections. The first part provides a general overview of the post 1900 evolution in not-for-profit financial reporting. The second section discusses significant issues relative to what has been referred to as a revolution in financial reporting practices and standards for not-for-profit institutions. Two primary issues dealt with are (1) the effort to develop a conceptual framework or constitution for financial reporting and standard-setting and (2) the important developments in the mechanics of the standard-setting process. The third section describes recent events and the present status of not-for-profit financial accounting. The emerging issues appear to be whether profit oriented and not-for-profit reporting will be consolidated under one framework and whether there is to be continued separation of the standard-setting process.

Terms used to describe entities outside the business sector include: philanthropic, nonprofit, not-for-profit, nonbusiness, and others. The Financial Accounting Standards Board (FASB) has elected to refer to them collectively as "nonbusiness,"[1] and this term will be used throughout this article.

Part I: Post 1900 Evolution

Introduction

The evolution of nonbusiness accounting in the United States began around the end of the 1800s. The beginning of interest in the area can be attributed to the fact that by the mid 1890s, urban areas were growing three times as fast as rural areas.[2] This surge of expansion required improvements in administration and in control of information. Over the years, governmental and nongovernmental accounting have been closely linked. As a result, fund accounting techniques that were developed principally by governmental units became generally accepted in the entire nonbusiness sector. As commonly practiced, fund accounting has provided a record of management's actions in terms of funds received and disbursed. This approach evolved from the trustee type of relationship between managers and sponsors of nonbusiness entities. In other words, stewardship became the focal point of the traditional fund accounting model.

Since little in the way of nonbusiness accounting systems developed earlier than the turn of the century, the history of governmental and institutional accounting can be considered to have begun around 1900 with many poor and underdeveloped practices carried forward in spite of their inadequacies.[3] Governmental nonbusiness units led the way in forming the budgetary systems that became a significant part of fund accounting techniques. The following paragraphs trace the evolution and development of nonbusiness accounting on a decade by decade basis.

Early Developments

Codifications of basic municipal accounting principles appeared around 1910; the most notable being the *Handbook of Municipal Accounting* by the New York Bureau of Municipal Research in 1913.[4] According to Dahlberg, the Bureau was born in 1906 out of the needs of the times, especially the need to develop methods of assisting the poor.[5] It was the first organization to direct its efforts exclusively to the problems of city government. Also during this decade, several states developed budgetary systems for operations and control.[6] Thus, local governments, rather than the federal government, took the lead in the earliest development of principles of accounting for nonbusiness entities. Budgetary accounting systems developed and codifications of principles appeared, yet concerned parties debated the merits of accrual versus cash basis accounting in municipal systems; and many nonbusiness entities emulated a fairly well established commercial accrual accounting model.[7]

In the 1920s the first significant literature on governmental and institutional accounting appeared.[8] This literature formed the foundation for the field and stimulated more interest in the area. The Federal Budget and Accounting Act was passed in 1921. This legislation led to adoption of formalized budgetary practices at the federal level, but was ineffective in development of sound accounting and auditing practices.[9] The Act created the Government Accounting Office (now the General Accounting Office or GAO) and the position of Comptroller General (appointed by the President and accountable to Congress) with the responsibility for all accountancy, including standard setting, at the federal level. Additionally, the Act created the Bureau of Budget (now the Office of Management and Budget) and assigned the Bureau responsibility for assembling all departmental appropriation requests for presentation to Congress.

Through these early years, developments in nonbusiness accounting were spotty. Different levels of government plodded along, each at its own pace, each with its own interpretation of accounting and recordkeeping procedures. The financial reporting abuses that were brought to public attention by the securities market crash led to demands for development and use of sound accounting practices in all sectors of the economy. At the time, R. P. Hackett wrote that: "We must satisfy ourselves as to where the fault lies in the retarded development of this (nonbusiness) branch of accounting."[10] Hackett cited several examples of inadequate fund accounting systems employed by municipalities and other nonbusiness entities that resulted in poor, misleading, or incomplete information being provided by those entities. He concluded that such an undesirable state of affairs was due to the American Institute of Accountants' (predecessor of the American Institute of Certified Public Accountants, i.e., AICPA) lack of interest in the area of governmental and institutional accounting and to inadequate university curricula. Few if any courses were taught, and texts on the subject were scarce.

By the late 1920s, nevertheless, the custodial function of nonbusiness management came to dominate the approach to nonbusiness accounting. The commercial accounting model for nonbusiness entities fell into disfavor and the receipts/disbursements approach of fund accounting became more widespread.[11] Still, generally accepted accounting principles for nonbusiness financial accounting had not been formulated and implemented. In a 1926 speech, Lloyd Morey, a major contributor to early nonbusiness accounting thought, asserted the following: "As I observe the methods followed in keeping public accounts . . . I am always impressed by the apparent failure to discern their true functions and consequently the correct principles which should be followed in their operation. It has often been arbitrarily and, I believe, incorrectly assumed that the procedure commonly followed in accounts of private business can be applied without material modification to public accounts."[12]

In the 1930s the National Committee of Municipal Accounting (NCMA) was formed under the auspices of the national organizations of public accountants and public finance officials.[13] The NCMA was the first nationwide effort to establish nonbusiness accounting principles and standards to replace previous parochial efforts.[14] The Committee was spawned from many concerns including bond defaults, the Depression, and federal government interference in state and local affairs, pressure exerted by the Securities and Exchange Commission (SEC).[15] The NCMA compiled two documents, "Municipal Accounting Statements"[16] and a set of "Municipal Audit Procedures."[17] These publications had a significant impact on conceptual and practical viewpoints in municipal and other nonbusiness fields. They suggested acceptable basic accounting principles, formats for financial statements, and procedures for independent audits.

At the federal level, jurisdictional in-fighting among the GAO, Treasury Department, Bureau of Budget, and other agencies over responsibilities concerning accounting functions resulted in a lack of uniformity in federal financial reports. These conflicts led to a preoccupation with detailed voucher examinations and verifications centering on procedural compliance and legality rather than to concern for providing anything resembling useful management information.[18] Thus, by the late 1930s, federal accounting lagged behind development at the local level.

In the nongovernment sphere, college and university officials formed a study group which published basic standards of financial accounting and reporting for their institutions. Also, educators began to change their attitudes toward nonbusiness accounting. College courses in governmental and institutional accounting appeared, as did research studies and publications on the topic, including a number of needed texts on the subject.[19]

Federal legislation provided major impetus for the development of governmental accounting in the late 1930s by dramatically increasing the volume of information to be processed and reported at the state and local levels. The Social Security Act, projects administered by the Works Progress Administration and the Public Works Administration, old age assistance programs, unemployment compensation programs, etc., prompted the refinement of information systems.

An Era of Progress Emerges

As the nation recovered from the Depression and approached the war years, growth in many segments of the nonbusiness environment signalled the inadequacies in accounting and reporting systems. The growth and rising importance of the nonbusiness sector is evident in the percentage of Gross National Product (GNP) accounted for by the nonbusiness sector of the economy. Between 1929 and 1940, the percent of GNP accounted for by the nonbusiness sector increased by about 50%, changing from 12.5% to 18.5% of GNP. Between 1940 and 1960 this percentage increased by about another 40%, changing from 18.5% to 25.8% of GNP. An additional 5% increase occurred between 1960 and 1970 when the nonbusiness sector accounted for 27% of GNP.[20] From the 1930s to the 1970s, the foundations upon which today's procedures are based were established and developed.

The 1940s proved to be an extension and expansion of developments that began in the 1930s. The principles posited by the National Committee on Municipal Accounting were refined and strongly promoted, resulting in their widespread acceptance and use. The

Municipal Finance Officers Association (MFOA) supported these principles and supplemented them with its own publications and research studies. During this era, municipal accounting made great strides to overcome its deficiencies, and there were spillover effects accruing to slower moving county and state units.[21]

At the federal level, the budgetary approach was, by now, firmly entrenched and was being strengthened. The GAO, as a result of new legislation, established a Corporation Audits Division which introduced workable methods for auditing government corporations (e.g., the Tennessee Valley Authority). This led to a growth in accounting expertise within the GAO and there was an influx of CPAs to its staff.[22] While most agencies and departments within the federal government had developed adequate accounting procedures, there was no basic source or focal point of financial information drawing all of the segments together to present a single complete report for the entire government. Even though many problems plagued accountancy at the federal level, a newly appointed Comptroller General was able to promote cooperation within the federal government. As a result, the heads of the GAO, Treasury Department, and Bureau of Budget formed a Joint Accounting Improvement Program (JAIP) which recognized the need for uniformity, central direction, and consolidation of efforts. Also, Congress created the Commission on Organization of the Executive Branch (the Hoover Commission) to study the organization of government agencies.[23] The efforts of these groups came to fruition in the early 1950s.

The accounting profession began to take on a more conspicuous role in government accounting in the 1940s. The American Institute of Accountants created a Committee of Federal Accounting in 1947 to work in cooperation with the Hoover Commission. As further evidence of the profession's interest, the Certified Public Accountants (CPA) examinations began to include questions concerning governmental and institutional accounting, and colleges and universities began to offer elective courses on governmental accounting.[24]

Morey summed up the situation as of the end of the 1940s:

> There is no longer any doubt as to what constitutes good accounting, reporting, and auditing for public bodies. The work of the National Committee on Municipal Accounting in particular, in establishing standards and models in these subjects, provides an authority to which officials, accountants, and the public may turn with confidence. Like any

> other body of standards, these materials need to be constantly re-examined as to their continuing validity.[25]

Basically, traditional fund accounting was in full swing by the end of this decade.

The Winds of Change

Until the 1950s, however, many nonbusiness (especially nongovernment) agencies were relatively small and received a great share of their support from wealthy patrons.[26] Beginning in the 1950s, a shift occurred whereby a good deal of support began to flow in from corporate donors, government sponsorship, and from increased contributions by the middle class. The support base for nongovernmental nonbusiness organizations grew, and according to a 1977 Treasury Department report it reached a level of $80 billion by the middle of the 1970s.[27]

A shift in accountability accompanied the shift in support. A growth in demand for information evolved with the growth of nonbusiness organizations and the expanded support base. As the sources of support became more diverse, donors began to insist on more information about the activities and use of resources entrusted to fund managers. Existing reporting standards were designed to satisfy a handful of donors. Thus, the informational output of then contemporary fund accounting procedures proved to be inadequate because it focused mainly on fiscal compliance, i.e., whether spending limitations were being adhered to. Output did not enable users to ascertain whether entities could remain or be financially viable; there was little information on efforts and achievements of specific programs; and, seldom was there any indication of the effectiveness of management performance. The widespread demand for these types of information was in the embryonic stages.[28]

The epicenter of change in the nonbusiness sector in the 1950s rested at the federal government level. As a result of the Hoover Commission and the JAIP, a bevy of legislation was passed, most notably the Budget and Accounting Procedures Act of 1950. This Act required managers of all federal departments to implement and maintain systems of internal control. It also called for the implementation of accrual accounting and assigned the responsibility for establishing federal accounting and financial reporting standards to the GAO.[29]

The GAO published its first accounting principles from 1952 through 1957 in memorandum form. These principles were based on the generally accepted accounting principles (GAAP) developed by the Committee on Accounting Procedure of the American Institute of Certified Public Accountants in its Accounting Research Bulletin series. In late 1957, the GAO combined all of these memoranda in a manual entitled "Title II," in which it incorporated definitions, reporting requirements and formats, descriptions of internal control systems, etc. Title II requirements changed in the 1960s from being very detailed in prescribing recording methods and formats to being general in terms of the information to be compiled by various agencies.[30]

The Seeds of a "Revolution"

The 1960s ushered in the development of industry accounting manuals developed by nonbusiness industry groups (hospital associations, museum groups, college and university organizations, etc.). These manuals addressed each group's specific problems and had limited application. In 1968, the National Council on Governmental Accounting (NCGA), the present successor of the National Committee on Municipal Accounting, published what is known as the blue book, "Governmental Accounting, Auditing, and Financial Reporting" (GAAFR) which became the primary authoritative statement on the application of GAAP to state and local governments.[31] GAAFR primarily addressed internal reporting and dealt with fund accounting and budget conformance rather than effective and efficient use of funds. GAAFR was accepted by the AICPA.

Meanwhile, the accounting profession devoted what seemed to be minimal attention to the problems of nonbusiness entities. Malvern Gross advanced the following reasons for the profession's apathy: (1) nonbusiness concerns still had a relatively low profile; (2) outsiders believed that the organizations were performing fairly well; (3) legal risks of audits were minimal; (4) audit fees were inadequate; and, (5) audits were, in essence, a community service.[32] However, by the late 1960s and early 1970s the apathy disappeared due in large part to the growth of public awareness.

"Public right to know" permeated the new era. A great deal of proposed legislation ranging from disclosure requirements to active government regulation was considered. The new attitude intensified with Watergate and the financial problems of New York City, and remains stoked currently by such events as the mismanagement of the Regional Transit Authority in Chicago, and the financial difficulties of the social security system. This stage of development of nonbusiness accounting has been called a revolution by Gross.[33]

He traced the origin of the revolution to a blue-ribbon commission instituted and supported by private citizens concerned with the capacity of nonbusiness entities to meet public needs and to make these organizations more responsive to their constituencies. These events do indeed mark the beginning of a different attitude toward nonbusiness accounting because changes in basic concepts and ideas relative to financial accounting and reporting began to emerge.

The Commission on Private Philanthropy and Public Needs (Filer Commission) came into being in the fall of 1973.[34] The Commission established a study group which formed an accounting advisory committee consisting of four accountants. The advisory committee concluded, among other things, that: (1) reporting to the public needed improvement; (2) fund accounting techniques produce reports that are difficult to understand; and, (3) if the private sector did not improve on its reporting weaknesses, government intervention would be encouraged with the possibility of government goals being imposed upon contributor goals.[35]

The advisory committee produced recommendations which it addressed to the Filer Commission and to the accounting profession in October, 1974. The objective of the report was to spark discussion and action within the profession. The major recommendation was that a single uniform set of accounting principles be adopted and followed by nonbusiness organizations.[36]

This recommendation was in stark contrast to the then prevailing environment. Along with specific industry-produced guides, the AICPA was busy preparing specific industry audit guides. In 1972, the AICPA released an audit guide for hospitals;[37] in 1973, it released an audit guide for colleges and universities;[38] and, in 1974, it released an audit guide for voluntary health and welfare organizations (a revision of a 1966 version including more forceful views of the profession).[39] These guides were based on industry peculiarities.

Development in the governmental area was not idle. The MFOA, besides creating GAAFR in 1968, devised an industry audit guide for state and local government units which was published by the AICPA in 1974.[40] The American Accounting Association (AAA) was also quite active in urging reform at this time. The AAA prepared several committee reports in the area of accounting, including a 1971 report on practices of not-for-profit organizations,[41] a 1972 report on concepts applicable to the public sector,[42] and a 1974 report on not-for-profit organizations identifying issues and research implications.[43] These reports all seemed to agree with the conclusion that ". . . the greatest challenges for accountants in the public sector lie in finding . . . meaningful relationships . . . for public accountability . . . (for) all public officials."[44] Thus, while a diversity of "acceptable" accounting practices was developing, there was also a call for a single integrated set of accounting principles for nonbusiness.

The Movement Gains Momentum

The activities of the mid 1970s were the birth of the accounting profession's real concern for the nonbusiness sector. Besides the previously mentioned efforts, the Accounting Standards Executive Committee (AcSEC) of the AICPA established in May, 1975 a subcommittee to develop accounting principles and reporting practices for nonbusiness entities not covered by existing audit guides. In 1978, the AICPA issued a Statement of Position (SOP) entitled "Accounting Principles and Reporting Practices for Certain Nonprofit Organizations."[45] According to Steven Woolf of the AICPA Washington office, this statement affects some five hundred thousand organizations.[46]

Five major recommendations were advanced in this SOP.

1. The organizations should prepare a statement of activity to show all expenses and major sources and amounts of revenues and support. Principal sources and amounts of additions to plants, endowments, and other capital funds should also be reported. The SOP stated that the nonbusiness entities, even though not established to earn profits, must generate resources greater than obligations in order to survive. This type of information was deemed important to contributors, trustees, beneficiaries, and creditors.
2. Entities should report separately the expenses related to fund-raising, membership development, other general expenses, and costs for each major program. This would allow interested parties to determine the purposes to which contributions are applied.
3. The nonbusiness unit should prepare a balance sheet.
4. The organizations should prepare a statement of changes in financial position.
5. The entities should use accrual accounting techniques for reporting purposes.

These recommendations, differing materially from traditional fund accounting, were given significance when the FASB expressed that certain SOPs were to be considered preferable accounting principles.[47] The literature of the late 1970s contains arguments for the use of accrual accounting techniques to replace fund accounting.

Even by the end of the 1970s, no single consistent set of reporting principles existed for all nonbusiness enterprises. Since one of the projects of the Financial Accounting Standards Board (FASB) is to develop a conceptual framework, upon which logical, consistent standard-setting for financial accounting and reporting could be based, the opportunity to develop a single set of accounting concepts based on sound theory became available.

Part II: A Conceptual Framework and a Standard-Setting Process for the Nonbusiness Sector

The FASB's first Statement of Financial Accounting Concepts (SFAC) dealing with the conceptual framework of accounting specifically addressed business enterprises.[48] In 1977, the FASB commissioned Robert Anthony to conduct a study exploring the conceptual accounting issues for nonbusiness organizations.

The Anthony Study was based on the premises that financial statements should articulate with each other and that users of financial statements are reasonably well informed. Anthony discussed tpes of entities to be included in the nonbusiness category as well as appropriate considerations of user groups and uses of reported information. As a result of Anthony's research, several issues related to nonbusiness entities were identified. Four points are especially relevant to this discussion.

1. Is the following list of primary users of financial report information adequate for the purpose of identifying needs for such information: governing bodies, investors and creditors, resource providers, oversight bodies, and constituents?
2. Is the following list of the types of financial report information needed by users adequate as a basis for deciding how best to meet these needs: financial viability, fiscal compliance, management performance, and cost of services provided?
3. How, if at all, should business organizations be distinguished from other organizations for the purpose of developing accounting concepts?

4. Should a single set of concepts apply to all types of nonbusiness organizations, or should there be one set for governmental organizations and one or more additional sets for nongovernmental, nonbusiness organizations?[49]

In other words, are separate conceptual frameworks necessary for business and nonbusiness entities and are separate frameworks necessary within the nonbusiness sector for government versus nongovernment organizations? If the profession opts for multiple frameworks, a problem will develop in the nonbusiness sector. Many nonbusiness entities behave like business entities, i.e., they derive financial resources from the sale of goods and services. Other nonbusiness organizations do not behave like business organizations, i.e., they derive financial resources from sources other than the sale of goods and services. Should "businesslike" nonbusiness entities be classified as business or nonbusiness? Also, would the profession need a separate authority and a separate standard-setting process for each entity classification? If so, questions are likely to arise concerning the support, controls, responsibilities, authorities, etc. of the separate standard-setting bodies.

The recent literature contains a cornucopia of ideas, theories, and emotions arguing the pros and cons of the multiple conceptual framework and standard-setting issues. The Anthony Study includes a brief discussion of a good sampling of them. Arguments favoring multiple frameworks include:

1. Earnings, as emphasized in the FASB's objectives of financial reporting for business organizations, may not be an appropriate concept for nonbusiness.
2. Nonbusiness users have information needs not satisfied by earnings information such as financial viability, fiscal compliance, management performance, and cost of services provided.
3. The federal government can be excluded as sovereign since the Comptroller General has statutory authority to set accounting standards for the federal government.
4. Nonbusiness industry peculiarities are too numerous to establish one set of concepts for all types of nonbusiness entities.
5. Financial reports of state and local governmental organizations should be prepared for all citizens, where-

as reports of other nonbusiness organizations are of interest only to specific groups.

6. A large body of generally accepted practices in relation to governmental accounting already exists.
7. Current practices in governmental and nongovernmental entities are so diverse that if a single set of concepts evolved, either group would need to learn a fundamentally different approach to accounting.
8. Government and nongovernment organizations' financial reports are seldom, if ever, compared, therefore, a single set of concepts are not necessary.[50]

Arguments in opposition to multiple frameworks found in the Anthony Study include:

1. Differences that exist between business and nonbusiness entities are really not significant enough to justify separate conceptual frameworks, and nonbusiness peculiarities such as nonrevenue resource inflows and restrictions on spending can be dealt with within a conceptual framework which includes business entities since financial accounting concepts[a] are essentially the same in both types of enterprises.
2. At the standards or principles level, some separate statements may be desirable and feasible for nonbusiness organizations similar to the manner in which certain industries receive "special" treatment.
3. Nonbusiness organizations must survive by generating resource inflows that exceed obligations, and these factors could be illustrated in a statement of activity which is very similar to a statement of earnings.
4. Multiple sets of concepts would require fitting a particular organization into one set or the other resulting in some perplexing classification problems.
5. A simple system of one set of concepts is preferable to a more complex system of multiple sets of concepts.
6. Nongovernmental and governmental organizations both have similar responsibilities of accountability to the public.

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[a]Note: Certain economic concepts such as the reporting entity, financial position, cost of services rendered, results of operations or activities, changes in financial position, etc. are common to all economic organizations.

7. The reason for the diversity in current nonbusiness industry practice is purely historical resulting from the absence of an overall conceptual framework rather than from real differences in the organizations.
8. Multiple sets of concepts would increase difficulty in understanding financial statements because of increased implications of separate concepts.[51]

Ultimately, the question becomes whether separate conceptual frameworks and/or standard-setting processes should exist for business, nongovernmental nonbusiness, and governmental nonbusiness entities. Both sets of arguments relative to separate frameworks contain salient points. Nevertheless, a brief expansion of the points concerning whether earnings generation and measurement are equally appropriate for business and nonbusiness entities provides a basis for judging the feasibility of the development of a single conceptual framework for all entities as explained in the next paragraphs.

Although the nonbusiness entities may not be involved in the earnings process as an indication of performance and as a basis for return to owners, the survival of nonbusiness entities requires at least a balance of resource inflows and accomplishments (i.e., some kind of breakeven). In other words, resource inflows necessary for continued operation may be impossible to generate unless the entity achieves accomplishments commensurate with the resources devoted to it. This is similar to the necessity of a business entity to generate adequate returns to investors. Thus, the means of survival for both business and nonbusiness entities are very similar. Also, as John C. Burton pointed out, "cost measurement in economic terms is a legitimate objective of both private and public sectors, and the largest number of 'accounting' problems seem to arise in this process."[52]

Combining the ideas above with an emphasis on an information approach rather than a net income approach to concepts and standard setting implies that one conceptual framework is feasible with an occasional separate standard of financial accounting and reporting being set for specific entities. This is so because in an information approach, standards are based on supplying information relevant to identified user needs. On the other hand, in the net income approach, standards are based on the transactional effort of an event on income measurement. If the main concern is providing information rather than measuring income, the idea of implementing one framework is enhanced. Net income can still be an appropriate concept since it is important to users of business entity information. Nevertheless, net income would not necessarily be the focal point of concept formulation and standard setting, thus allowing nonbusiness entities to operate under the same constitution as business entities. The FASB appears to be leaning toward an information approach as implied by its objectives spelled out in SFAC No. 1,[53] even though the Board does reiterate that the income statement and accrual accounting provide the focal point of the information for users trying to assess future cash flows. Thus, the potential for a single conceptual framework is enhanced.

The above conclusion is intuitively attractive. However, as Engstrom suggested, issues related to determination of a single or multiple conceptual framework structure should be resolved following a logical thought process.[54] He claims that accounting information and accounting principles should facilitate resource allocation; and, more specifically, how resources should be allocated to the nonbusiness as opposed to the business sector. Accepting resource allocation as a basis, user-groups in the nonbusiness sector could be identified, followed by a determination of their informational needs. The next logical step would be to determine how to meet user needs (i.e., appropriate accounting methods, reporting formats, etc.). After deciding how to meet user needs, the uniformity of principles issue could be addressed.

This type of approach is consistent with the FASB's concepts statement concerning the qualitative characteristics of information. According to SFAC No. 2, information should be, among other things, understandable, relevant, comparable, and reliable.[55] Information with these characteristics is necessary for rational resource allocation decisions. Comparability is especially important so that allocation of resources to different sectors can result in the most efficient resource utilization possible. It does seem, however, that one framework would provide better comparability of information than could be achieved through information derived from multiple frameworks. Even though the authors believe that the aforementioned points and arguments indicate that a single conceptual framework for all entities, is preferable, this issue and its implications for standard-setting are obviously debatable. The final section of this article describes the events that have occurred relative to these issues in the five years since the Anthony Study was released.

Part III: The State of Affairs from 1979 to 1984

Introduction

Weaknesses in the traditional fund accounting model for nonbusiness entities became evident as more resources flowed into the nonbusiness sector as discussed in Part I. The discussion in the previous section highlighted the conceptual issues that have emerged in the recent developments in accounting thought and practice relative to the nonbusiness sector. Serious problems and important questions arose calling for a well-reasoned, professional response to keep the changes from degenerating into chaos. The following paragraphs portray the recent actions of certain authoritative accounting bodies in response to the demands for changes in financial accounting and reporting practices and standards for nonbusiness entities.

Activities, decisions, and developments of the last five years indicate there is still no consensus on the ultimate direction nonbusiness accounting standard setting will take. The federal government has a legal right to adopt standards independently of other interested parties. The FASB is moving in its chosen direction by working on a general framework. Committees representing state and local governmental units are taking more definite stands by working on a specific framework and specific standards. These actions indicate efforts have been made to manage the changes, but presently these efforts are not completely centrally organized.

Financial Accounting Standards Board (FASB) Action

The FASB appears to favor development of a single conceptual framework for all accounting entities. In December, 1980, the FASB issued SFAC No. 4, "Objectives of Financial Reporting by Nonbusiness Organizations."[56] The Board concluded that it may not be absolutely necessary to develop an independent conceptual framework for any particular category of entities. The objectives developed in the SFAC No. 4 reveal that financial reporting by nonbusiness organizations should provide information that is useful to present and potential resource providers and other users in: (1) making rational decisions about resource allocation, (2) assessing the quality of services provided and the ability to continue to provide services, and (3) assessing how managers have performed their stewardship function.[57]

The objectives further stated that financial reporting should provide the following information about reporting entities: (1) economic resources, obligations, and net resources, as well as events that change resources and resource interests; (2) performance during a period including periodic changes in the amount and nature of net resources and service efforts and accomplishments; (3) how cash and liquid resources are obtained and spent and other factors that affect liquidity; and, (4) any explanatory material needed to help users understand the financial information provided.[58]

The statement suggested three major distinguishing characteristics of nonbusiness organizations. Significant resources are received from resource providers who do not expect repayment or proportional return of services. The purpose of operations is primarily other than profit generation. Finally, there is an absence of defined ownership interests. These characteristics may result in transactions that are not common to business organizations (contributions, grants, taxes, etc.). The Board was also careful to state that the distinction between business and nonbusiness organizations will not always be perfectly clear.[59]

The FASB decided that the aforementioned objectives along with those developed for business organizations in its first SFAC would serve as the foundation for a single integrated conceptual framework for financial accounting and reporting. However, the FASB also deferred its decision on whether these new objectives should apply to state and local government units.[60] One reason behind this action was that a new structure outside the FASB was being proposed for setting financial accounting and reporting standards for state and local unity. Nevertheless, the Board claimed that it had no persuasive evidence that its objectives for nonbusiness organizations are inappropriate for governmental units.[61]

National Council on Governmental Accounting (NCGA) Action

Many of the latest developments in nonbusiness accounting relate to the problem of how state and local governmental units will fit into whatever framework is established. In June, 1979, the U.S. Department of Housing and Urban Development (HUD) awarded a grant to the NCGA to develop a conceptual framework for state and local government accounting and financial reporting.[62] The impetus for this project came from a 1979 restatement of GAAFR, referred to as *Statement 1,* to update, clarify, amplify, and reorder the 1968 GAAFR.[63] The restatement was triggered because its sponsors believed that fund accounting provisions had become too complex, fund reporting did not provide an overview of a governmental unit as a whole, and that budgetary reporting provisions were inconsistently applied.[64] Thus, the NCGA decided that a framework was necessary for setting standards of financial accounting and reporting that would be logical, consistent, and responsive to the needs of users.

In early 1982, the NCGA issued its first statement of concepts relative to its conceptual framework project.[65] The statement provided objectives to guide the future development of accounting and reporting standards for state and local governments. According to the NCGA's *Concepts Statement 1,* the overall goal of accounting and financial reporting for state and local governmental units is to provide: (1) financial information useful for making economic, political, and social decisions; (2) a report on accountability and stewardship; and, (3) information useful for evaluating managerial and organizational performance.[66]

Under the umbrella of this overall goal, the statement lists and discusses a set of basic objectives and their component parts. These objectives include providing information useful for:

1. determining and forecasting the flows, balances, and requirements of short-term financial resources of the governmental unit;
2. determining and forecasting the financial condition of the governmental unit and changes therein;
3. monitoring performance under terms of legal, contractual, and fiduciary requirements;
4. planning and budgeting, and for forecasting the impact of the acquisition and allocation of resources on the achievement of operational objectives;
5. evaluating managerial and organizational performance; and,
6. communicating the relevant information in a manner which best facilitates its use.[67]

These objectives are similar to the FASB's objectives for nonbusiness entities but they are a bit more specific.

Federal Government Action

During this same period, the federal government also began working on a conceptual framework of its own with the primary objective of providing information useful in assessing management's performance and stewardship.[68] Since the GAO is charged with the development of accountancy for the federal government, it is not bound by conclusions of the FASB or NCGA.

By 1981 the GAO issued three exposure drafts on its conceptual framework for federal accountancy which included discussions on objectives of financial reporting, definitions of reporting elements, and measurement concepts. It also saw passage of the Federal Integrity Act of 1980. Under the requirements of this act, the head of each executive agency must annually submit a report on the adequacy of his agency's system of internal accounting and administrative controls. The purpose of the act is to gain reasonable assurance: (1) of compliance with cost limits and obligations; (2) that funds, property, and assets are safeguarded from waste, loss, unauthorized use, or misappropriation; and, (3) that revenues and expenditures are properly reported for reliable statements and reports.[69]

An Attempt at Compromise

In April, 1980, the Governmental Accounting Standards Board Organization Committee (GASBOC) was created. This committee resulted from informal discussions among various professional groups including the AICPA, Financial Accounting Foundation (FAF), NCGA, GAO, and others. The committee's purpose was to consider whether a need existed for a new structure to establish financial accounting and reporting requirements for state and local government. If so, GASBOC was to develop detailed recommendations regarding the new structure.[70]

In February, 1981, GASBOC released an exposure draft recommending a new structure similar to the FAF structure with an oversight foundation, a full-time standard-setting board, and an advisory council. A separate Governmental Accounting Foundation (GAF), Governmental Accounting Standards Board (GASB), and a Governmental Accounting Standards Advisory Council (GASAC) separate from FAF/FASB structure were proposed.[71]

The FAF opposed a completely separate structure since a one-board approach seemed to be more appropriate; however, the FAF indicated in July, 1981, that it was willing to support a GASB if it were to operate under the auspices of the FAF, whose board of trustees would be expanded to include three governmental representatives. Nevertheless, the FAF cautioned that the proposal depended on its ability to raise funds for the new structure from the government and elsewhere. In 1984, the GASB became a reality. The first five board members were named as of July, 1984,[72] and in the same month the GASB took its first action. This first statement, *Authoritative Status of NCGA Pronouncements and AICPA Industry Audit Guide,* in essence accepted all the currently effective pronouncements of the NCGA as well as the AICPA's audit guide entitled *Audits of State and Local Governmental Units*.[73] With this as its starting point, the GASB will proceed with its charge to develop financial accounting standards for the governmental/nonbusiness sector.

A Perspective on the Direction of the Revolution

Only as the entire conceptual framework issue is further developed will the question as to whether only the FASB framework will exist for all nonbusiness entities or if the NCGA framework as accepted by the GASB will provide a completely separate constitution of accounting for state and local governmental units. Overall, however, it is apparent that a revolution in the nonbusiness arena has occurred and is now settling into a more organized form of evolution. The revolution has occurred concurrently with another revolution where an accounting emphasis has taken an informational approach and where an overall constitution for accounting has begun to take shape. No matter what the future holds, the accounting profession should continue to use the best of accounting thought in the business, nonbusiness, and governmental sectors of our economy so that rational choices will be made.

Summary

Financial accounting and reporting in the sphere of nonbusiness entities developed under the umbrella of fund accounting techniques emphasizing the stewardship of funds. As interest in nonbusiness entities expanded, dissatisfaction with information provided by fund accounting emerged. When attempts to remedy this problem developed, questions emerged as to whether separate conceptual frameworks of accounting for business and nonbusiness organizations should be developed. The FASB's current position is that separate conceptual frameworks for business and nonbusiness entities are neither necessary nor desirable. However, the FASB does support a separate Governmental Accounting Standards Board, which is now in operation, responsible for standard-setting in the government sector. Nevertheless, the FASB seems to believe that several sets of objectives for business, nonbusiness, and governmental organizations can exist and be served by a single integrated conceptual framework. This appears to remain true even though the GASB has accepted the initial conceptual framework standards of the NCGA.

This article has presented the major facets of the evolution of and revolution in nonbusiness accounting that have resulted in the present state. Many specific events in the evolution and revolution were not reported for the sake of brevity. Also, many of the efforts and achievements described herein are debatable as to their utility, potential, and practicality. Nevertheless, the article has attempted to portray that fund accounting techniques for nonbusiness entities developed slowly and became relatively formalized by the 1950s. However, the 1960s and 1970s revealed that a diversity in applications of these techniques existed and the output of fund accounting was inadequate as the resources invested in the nonbusiness sector and interest in it swelled.

FOOTNOTES

[1]Financial Accounting Standards Board (1980b).
[2]Potts (1978), p. 518.
[3]Morey (1948), p. 227.
[4]Morey (1948), p. 227.
[5]Dahlberg as in Potts (1978), pp. 527-528.
[6]Morey (1948), p. 227.
[7]Potts (1978), pp. 520-527.
[8]Morey (1948), p. 227.
[9]Morey (1948), p. 228.
[10]Hackett, p. 123.
[11]Potts (1978), p. 535.
[12]Morey as in Potts (1978), p. 532.
[13]Flanagan, p. 4.
[14]Chatters, p. 101.
[15]Greathouse (1981), p. 59.
[16]National Committee on Municipal Accounting (1941).
[17]National Committee on Municipal Accounting (1939).
[18]Points and Michelson (1980-1981), p. 7.
[19]Morey (1948), p. 228.
[20]Ginzberg, Hiestand, and Reubens, p. 87. United States Department of Commerce, p. 418.
[21]Morey (1948), pp. 228-231.
[22]Points and Michelson (1980-1981), p. 7.
[23]Points and Michelson (1980-1981), p. 7.
[24]Morey (1948), pp. 230-231.
[25]Morey (1948), p. 231.
[26]Weinstein, pp. 1005-1006.
[27]United States Department of the Treasury, Volume II, p. 832.
[28]Weinstein.
[29]Points and Michelson (1980-1981), p. 8.
[30]Points and Michelson (1980-1981), pp. 8-9.
[31]Municipal Finance Officers Association (1968).
[32]Gross (1977a), p. 67.
[33]Gross (1977a), p. 66.

[34]Gross (1975), p. 55.
[35]Gross (1977a), pp. 69-70.
[36]Gross (1975), p. 59.
[37]American Institute of Certified Public Accountants (1972).
[38]American Institute of Certified Public Accountants (1973).
[39]American Institute of Certified Public Accountants (1974a).
[40]American Institute of Certified Public Accountants (1974b).
[41]American Accounting Association (1971).
[42]American Accounting Association (1972).
[43]American Accounting Association (1974).
[44]American Accounting Association (1972), p. 106.
[45]American Institute of Certified Public Accountants (1978).
[46]Woolf, p. 10.
[47]Financial Accounting Standards Board (1979), p. 1.
[48]Financial Accounting Standards Board (1978).
[49]Anthony (1978a), pp. 47, 52, 165, 185.
[50]Anthony (1978a), pp. 185-187.
[51]Anthony (1978a), pp. 187-191.
[52]Burton, p. 66.
[53]Engstrom (1979a), pp. 84-87.
[54]Financial Accounting Standards Board (1980a), p. 15.
[55]Financial Accounting Standards Board (1980b), p. 2.
[56]Financial Accounting Standards Board (1980b), pp. 19-22.
[57]Financial Accounting Standards Board (1980b), pp. 22-26.
[58]Financial Accounting Standards Board (1980b), p. 4.
[59]Financial Accounting Standards Board (1980b), p. 2.
[60]Financial Accounting Standards Board (1980b), p. 2.
[61]Greathouse (1981), p. 60.
[62]Municipal Finance Officers Association (1980a).
[63]Municipal Finance Officers Association (1980b).
[64]Municipal Finance Officers Association (1982).
[65]Municipal Finance Officers Association (1982), p. 2.
[66]Municipal Finance Officers Association (1982), pp. 2-3.
[67]Points and Michelson (1979-1980), p. 40.
[68]The Financial Integrity Act of 1980, pp. 28-29.
[69]Governmental Accounting Standards Board Organization Committee.
[70]Governmental Accounting Standards Board Organization Committee, pp. 8-11.
[71]Deloitte Haskins & Sells, p. 1.
[72]Late Developments (1984), p. 3.
[73]News Report (1984), p. 18.

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