



Course 106

Understanding Governmental Financial Statements

Description

This course is designed to help participants understand the basics of governmental accounting and how it differs from general financial accounting. It will include a discussion on types of funds and managing those funds.

Objectives

To provide an introduction to governmental financial statements:

- Format, basic content, and usefulness of financial statements
- Types of financial statements and key components
- Basic financial statement terminology

Who Will Benefit

- Elected Officials/Appointed Officials
- Local Government Employees/Local Government Auditors

About the Instructors

BRAD CRYER, Assistant Legislative Auditor/Director of Local Government Audit Services

Brad Cryer is the Director of Local Government Services with the Louisiana Legislative Auditor's (LLA) Office. He has more than 21 years of experience with the LLA and is responsible for local government and advisory services.

Brad's past experience includes financial and federal program audits at numerous state agencies, universities, boards, and commissions, as well as coordinating the LLA's information technology audits. He also spent several years as the assistant director responsible for the audit of the state of Louisiana's Comprehensive Annual Financial Report. More recently, Brad has been involved with the implementation of the LLA's statewide agreed-upon procedures. Brad is a Certified Public Accountant, a member of the American Institute of Certified Public Accountants, and a member of the Society of Louisiana Certified Public Accountants. He earned a Bachelor of Science degree in Accounting from Louisiana Tech University in 1996.


ERIC SLOAN, Advisory Services Manager

Eric Sloan has been a CPA for more than 30 years and has been working at the LLA for the past 18 years. Prior to coming to the LLA, Eric worked a total of 16 years in two different CPA firms, and worked for 2 years as the Controller of a multi-state engineering firm.

Eric currently serves as a Manager in the Advisory Services section of the LLA. Advisory Services focuses on providing guidance and recommendations to local governments for implementing/strengthening internal controls, ensuring compliance with laws, and implementing good business practices. Advisors also consult with local governments that are not fiscally healthy to help them move toward financial stability.

Eric is a graduate of Louisiana State University and is a member of the American Institute of Certified Public Accountants and the Society of Louisiana Certified Public Accountants.

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Understanding Governmental Financial Statements

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Objective



To make governmental financial statements more user friendly and understandable

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Agenda



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Basics of Financial Statements



1. What is a financial statement?
2. Who is responsible for preparing financial statements?
3. What key information is in financial statements?
4. Where does the financial information come from?
5. Who uses financial statements?
6. How are financial statements to be used by management?

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Basics of Financial Statements



1. What is a financial statement?

- * A formal record of the financial position **and** financial activities of a business, person, or other entity
- * Reflect current position and past performance and is based on a set of standards and guidelines (GAAP)
- * Should be reliable, timely, and comparable.
- * Used as a tool by management to provide accountability and transparency (tells a story)

Basics of Financial Statements



2. Who is responsible for preparing financial statements?

_____ is responsible for the preparation and fair presentation of the financial statements, **including** the design, implementation, and maintenance of **internal controls** relevant to their preparation and fair presentation.

Basics of Financial Statements



3. What key information is in financial statements?

A. Financial Position:

Reports what you own (assets), what you owe (liabilities), and the difference (equity) at a specific date

B. Financial Activities:

Reports the revenues, the expenses, and the difference (net profit/loss) over a period of time

Basics of Financial Statements



Financial Position: Assets

Types (listed in order of liquidity):

- * Cash
- * Investments
- * Accounts Receivable
- * Inventory
- * Restricted Assets
- * Capital Assets

Basics of Financial Statements



Financial Position: Liabilities

Types: (listed in order of due date – short term then long term)

- * Accounts payable (vendors)
- * Accrued expenses (payroll, interest, taxes, etc.)
- * Lease obligations
- * Bank loans
- * Bonds payable
- * Net pension liability (retirement)
- * Net other post-employment benefit (OPEB) obligation (medical)

Basics of Financial Statements

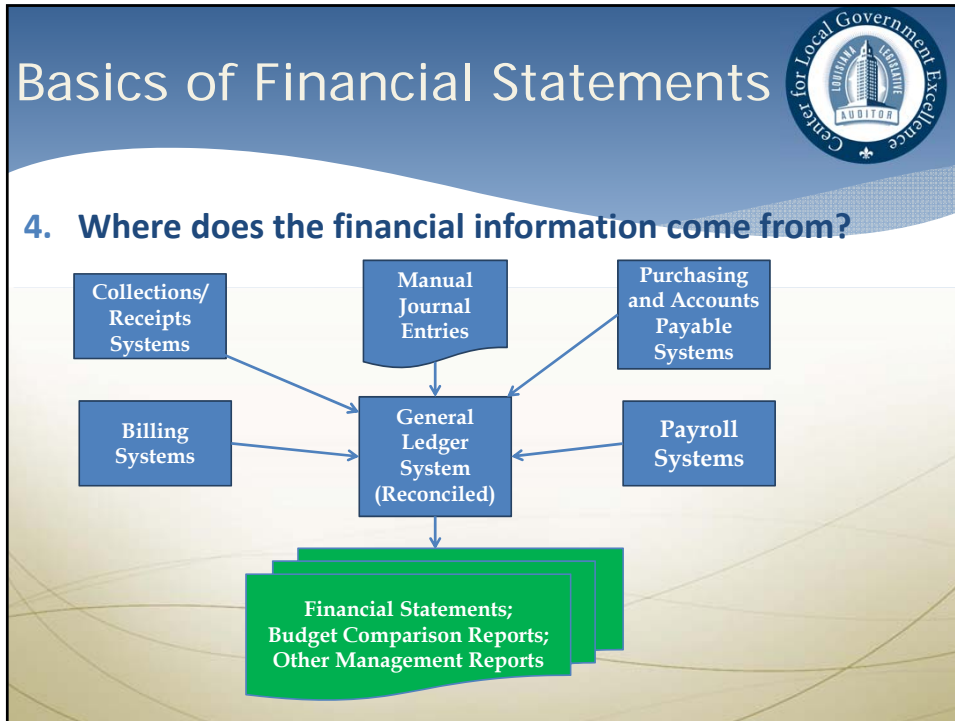


Financial Position: Equity


Terminology Differences

- * Individuals = Net Worth
- * Sole Proprietors = Owner's Equity
- * Partnerships and LLCs = Capital Accounts
- * Corporations = Retained Earnings
- * Governments = Fund Balance; Net Position

[Note: **Equity is a key indicator of financial health** as it shows whether the government is spending within its means.]



Basics of Financial Statements




5. Who uses financial statements and why?


- * Management and Board – To guide financial decisions (concern if not being used in the decision-making process)
- * Bankers and Creditors – To evaluate credit worthiness and to make lending decisions
- * Stakeholders and Investors - To evaluate investment/financial performance
- * Regulators – To evaluate financial stability (e.g., deficit, trends) and internal controls, and compliance with laws and grants

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Basics of Financial Statements




6. How are financial statements to be used by management?



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graph TD; Planning --> Budgeting; Budgeting --> MonthlyMonitoring[Monthly Monitoring]; MonthlyMonitoring --> AuditedAnnual[Audited Annual Financial Report]; AuditedAnnual --> Assessment[Assessment of Financial Stability]; Assessment --> Planning;
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Auditor's Role




CPAs generally provide three levels of financial statement services:

- 1. Audit** is the highest level of service (provides reasonable assurance that the financial statements are free of material misstatements) and an opinion is rendered. An audit enhances the degree of confidence that users have in financial statements.
- 2. Review** provides limited assurance on financial statements as the procedures performed are limited (less than audit).
- 3. Compilation** provides no assurance about the accuracy of financial statements. The CPA assists management in putting the information in appropriate financial statement format.

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Auditor's Role




What is the primary responsibility of an auditor?

1. To obtain and evaluate information/evidence to form an opinion on whether the financial statements are:
 - presented fairly in all material respects
 - in conformity with GAAP (Generally Accepted Accounting Principles)
2. To express the opinion in a written report that accompanies the financial statements.

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Auditor's Role



What is Materiality?

Materiality is the threshold amount above which missing/incorrect info in financial statements is considered to have an impact on the decision-making of users. The concept of materiality is applied by the auditor both in planning and performing the audit; evaluating the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements; and in forming the opinion in the auditor's report.

What is GAAP?

Generally Accepted Accounting Principles are the financial reporting rules and formats that auditors are required to follow to ensure consistency and comparability in reporting across the country.

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Auditor's Role



Types of auditor opinions given on financial statements:

1. Unmodified Opinion – the financial statements are presented fairly

This is the best opinion you can get on the financial statements and it is also known as a “clean” opinion.

The auditor has no concerns about the information included in the financial statements. There are no reservations on how the information is being reported and whether it is complete.

Auditor's Role



2. Modified Opinions - Three different types are:

- A. Qualified opinion – misstatements, individually or in aggregate, are **material but not pervasive** (e.g., audit evidence is not sufficient)
- B. Adverse opinion – misstatements are **both material and pervasive** to financial statements (i.e., financials do not present fairly)
- C. Disclaimer opinion – **auditor is unable to obtain sufficient audit evidence** on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive

Governmental Financial Statements



What is the GASB?

- * The Governmental Accounting Standards Board (GASB) was established in 1984 and is the independent organization that establishes and improves standards of accounting and financial reporting for U.S. state and local governments.
- * The GASB is recognized by as the official source of GAAP for governments.

Governmental Financial Statements



Louisiana's Audit Law (R.S. 24:513) requires the financial statements of local governments to be:

1. **Audited** if \$500,000 or more of revenues and other sources are received in any one fiscal year
2. **Reviewed** if \$200,000 or more but < \$500,000
3. **Compiled** if \$75,000 or more but < \$200,000
4. **Certified** (Sworn Statement) if \$75,000 or less

Note: Report submitted to the LLA no later than six months after close of fiscal year.

Governmental Financial Statements



There are key differences in the government environment compared to how private businesses operate.

For example, in government there is:

1. Lack of profit motive
2. Political processes (public elections, open meetings, etc.)
3. Power to tax for services provided
4. Unique required financial reporting (GASB establishes standards)

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Governmental Financial Statements



There are key differences in financial statements:

		Measurement Focus <small>(what accounts get reported)</small>	Basis of Accounting <small>(when rev./exp. get reported)</small>
A.	Private Businesses:		
	Financial statements (B/S, I/S)	Economic resources	Accrual
B.	Governments:		
	Government- <u>wide</u> statements	Economic resources	Accrual
	Governmental <u>fund</u> statements	Current financial resources	Modified Accrual
	Proprietary <u>fund</u> statements	Economic resources	Accrual
	Fiduciary <u>fund</u> statements	Economic resources	Accrual

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Governmental Financial Statements



Comprehensive Annual Financial Report (CAFR)

- Encouraged but is not required for local governments
- Presents information beyond the minimum requirements of GAAP (such as statistical data and additional schedules)
- CAFR allows entity to demonstrate the spirit of transparency to taxpayers (e.g., more disclosures)
- CAFR is required for annual participation in the GFOA's *Certificate of Achievement for Excellence in Financial Reporting Program*


Governmental Financial Statements



The CAFR used for exercises:

City of Covington, Louisiana
For the Year Ended December 31, 2015

Governmental Financial Statements



CAFR contents:

1. Introductory Section – Transmittal letter by management
2. Financial Section -
 - * **Independent Auditor’s Report**
 - * Management’s Discussion and Analysis (MD&A)
 - * **Basic Financial Statements**
 - * Required Supplementary Information
 - * Other Supplementary Information
3. Statistical Section – financial trend information, etc.
4. Reports Required by *Government Auditing Standards*
 - * Auditor’s Report on Internal Control and Compliance
 - * Schedules of Findings and Questioned Costs (Current & Prior Year)

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Governmental Financial Statements




Government financial statements are presented from two different perspectives in the same audit report:

1. **Fund Financial Statements (FFS)** focus on the government’s major funds (e.g., General Fund)
2. **Government-wide Financial Statements (GWFS)** present the total economic picture of the government – like a business [includes the long-term assets and long-term liabilities of the government]

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Governmental Financial Statements



1. Fund Financial Statements are prepared for:

- A. **Governmental Funds** - report revenue and expenditures of general operations
- B. **Proprietary Funds** - report revenue and expenses of business-like activities that are supported, in part, by fees or charges (similar to business)
- C. **Fiduciary Funds** - report monies that are held in custodial/trustee capacity for a third party (e.g., employees' retirement system)

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Governmental Financial Statements



Summary:

	A. Governmental	B. Proprietary	C. Fiduciary
Fund Types	1. General Fund 2. Special Revenue Funds 3. Capital Projects Funds 4. Debt Service Funds 5. Permanent Funds	1. Enterprise Funds 2. Internal Service Funds	1. Pension Trust Funds 2. Investment Trust Funds 3. Private-Purpose Trust Funds 4. Agency Funds
Required Financial Statements	1. Balance Sheet 2. Statement of Revenues, Expenditures, and Changes in Fund Balances	1. Statement of Net Position 2. Statement of Revenues, Expenses, and Changes in Fund Net Position 3. Statement of Cash Flows	1. Statement of Fiduciary Net Position 2. Statement of Changes in Fiduciary Net Position

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Governmental Financial Statements



A. Governmental Fund financial statements consist of:

- * **General Fund** - accounts for and reports all financial resources not accounted for and reported in another fund (e.g., admin., public safety)
- * **Special Revenue Funds** – accounts for and reports the proceeds of revenue sources that are restricted or committed to expenditure for specified purposes other than debt service/capital projects (e.g., sales taxes)
- * **Debt Service Funds** – accounts for and reports financial resources that are restricted, committed, or assigned to expenditure for principal and interest
- * **Capital Projects Funds** – accounts for and reports financial resources that are restricted, committed or assigned to expenditure for capital outlays
- * **Permanent Funds** - accounts for and reports resources that are restricted to the extent that only earnings, and not principal, may be used

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Governmental Financial Statements



1. Balance Sheet

[Components below are presented by each major governmental fund and the total of non-major governmental funds]

Accounting Equation:

Total Assets

+ Deferred Outflows of Resources [*use of asset applicable to future period*]


- **Total Liabilities**

- Deferred Inflows of Resources [*acquisition of asset applicable to future period*]

= **Total Fund Balance** [*a good measure of financial position/health*]

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Governmental Financial Statements




Constraints on Fund Balance (reported in up to five classifications as follows):

- * **Nonspendable** - amount of fund balance that is associated with specific accounts (**e.g., prepaid expenses, inventory**) that have been/cannot be spent
- * **Restricted** - includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation (**e.g., debt service**).
- * **Committed** - includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority (**e.g., capital outlay**).
- * **Assigned** - used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed (**e.g., contingencies**).
- * **Unassigned** - the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications.

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Governmental Financial Statements



2. Statement of Revenues, Expenditures, and Changes in Fund Balances

[Components presented by each major governmental fund and total of non-major funds]

Accounting Equation:

- Total Revenues**
- **Total Expenditures**
- = Excess (Deficiency) of Revenues over Expenditures
- +/- Other Financing Sources (Uses)
- = **Changes in Fund Balance**
- + Fund Balance at beginning of year
- = **Fund Balance at end of year**

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Governmental Financial Statements




Exercise

Governmental Funds - Financial Statements

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Governmental Financial Statements



QUESTIONS:

1. What pages contain the fund financial statements?
2. What are the major governmental funds?
3. What amount does the general fund owe on bonds?
4. What are total fines and forfeitures?
5. What is the change in fund balance for the general fund?
6. What is the cost of the general fund's capital assets?
7. What is the total unassigned fund balance amount?
8. What is amount of fund balance restricted for capital outlay?

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Governmental Financial Statements



B. **Proprietary Fund** financial statements are prepared for enterprise funds which are used to report any activity for which a fee is charged to external users for goods or services (e.g., water systems and landfills).

Governmental Financial Statements



Exercise

Proprietary Funds - Financial Statements

Governmental Financial Statements



QUESTIONS:

1. What pages contain proprietary fund statements?
2. What services are being provided to users?
3. What is the net pension liability amount?
4. What is the depreciation amount?
5. What is the change in net position amount?
6. What is the capital assets, net amount?
7. What is the unrestricted net position amount?

Governmental Financial Statements



2. Government-wide Financial Statements (GWFS)

- * GWFS report information about the government as a whole using the same accounting methods (e.g. accrual basis) used by private business
- * GWFS convert Governmental Fund Financial Statements to present a long-term view of the entity's finances

Governmental Financial Statements



Government-wide Financial Statements are the following two Statements:

1. Statement of Net Position
 2. Statement of Activities
- * These two financial statements report the government's net position and changes in it.
 - * It is important to review the changes (increases/decreases) in **net position** from year to year as it is one indicator of whether financial health is improving or deteriorating.


Governmental Financial Statements



The activities of governmental entities are divided into three categories (individual funds are not reported in GWFS):

1. **Governmental-type activities** include the government's basic services which are generally financed through taxes, intergovernmental revenues, etc. (e.g., general, public safety)
2. **Business-type activities** are financed in whole or in part by fees charged to customers (e.g., utility system)
3. **Fiduciary activities** include fiscal agent or custodial activities (e.g., tax collector, pensions, pass-through) – assets held in trust and are not included in the GWFS

Governmental Financial Statements




Exercise

Government-wide Financial Statements

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Governmental Financial Statements



QUESTIONS:

1. What pages contain government-wide financial statements?
2. What is the unrestricted net position of governmental activities?
3. What is the total net pension liability amount?
4. What are net receivables in the business-type activities?
5. What is the total change in net position?
6. What is the net (expense) of public safety - police?
7. What are the sewer revenues?
8. What are the property tax revenues?
9. What is the amount of total capital grants and contributions?

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Governmental Financial Statements



Notes to the Financial Statements:

- * Constitute an integral part of the basic financial statements (generally takes up the most number of pages)
- * Convey information essential for fair presentation of the basic financial statements that is **not** displayed on the face of the financial statements
- * Focus is on the primary government (that is, the governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate)

Governmental Financial Statements



Exercise

Notes to the Financial Statements

Governmental Financial Statements



1. Required Supplementary Information (RSI)

A. **Management's Discussion and Analysis (MD&A):**

A summary narrative prepared by management that focuses on current year financial data and generally provides a comparison with previous year's operations.

This section of the report is management's opportunity to present its analysis of the entity's activities and financial condition (is presented before the basic financial statements section).

Governmental Financial Statements




B. **Information Other Than MD&A:**

Includes schedules, statistical data, and other information that are an essential part of financial reporting that should be presented with, but are not part of, the basic financial statements.

For example:

- * **Budget to Actual Schedules** (General and Special Revenue Funds)

Governmental Financial Statements



2. Other Supplementary Information presented includes:

- * Financial Statements of Non-Major Governmental Funds
- * Schedule of Board/Council Compensation
- * Schedule of Agency Head Compensation, Benefits and Other Payments

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Governmental Financial Statements




Reports Required by Government Auditing Standards:

- 1. Independent Auditor’s Report on Internal Control** over Financial Reporting **and on Compliance** and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*
- 2. Schedule of Findings** and Questioned Costs
- 3. Summary Schedule of Prior Year Findings** and Questioned Costs

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Understanding Governmental Financial Statements



Questions and Comments?

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