

Center for Local Government Excellence



Understanding Governmental Financial Statements

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Learning Objectives

To provide you with an introduction to governmental financial statements:

- * Identify the different types of financial statements
- * Understand format and content of the financial statements
- * Key components of the financial statements
- * Basic financial statement terminology
- * How to read and understand financial statements

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Agenda



Slides	Topics
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Overview of Financial Statements



1. What is a financial statement?
2. What basic information is in financial statements?
3. Who is responsible for preparing financial statements?
4. Where does the financial information come from?
5. What are some questions that financial statements help answer?
6. Who uses financial statements?
7. How are financial statements to be used?

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Overview of Financial Statements



1. What is a financial statement?

- * A financial statement is a formal record of the financial activities and financial position of a business, person, or other entity.
- * Financial statements reflect current position and past performance and is based on a set of standards and guidelines (GAAP).
- * The financial information is presented in a structured manner and is the principal means of communicating financial information to users.
- * Financial statements are used as a tool by management to provide accountability and transparency (tells a story).
- * Financial statements should be reliable, timely, and comparable.

Overview of Financial Statements



2. What basic information is in financial statements?

- * Financial Position (at a specific date in time such as December 31st)
 - * **Balance Sheet** shows what you own, owe, and the amount left over:
Accounting equation: **Assets = Liabilities + Equity**
- * Financial Activities (for a period of time such as one month or one year)
 - * **Income Statement** shows if you are covering your expenses or not:
Accounting equation: **Income – Expenses = Net Income or Loss**
- * Specialized Statements such as Statement of Cash Flows (sources/uses)
- * Notes to the Financial Statements are an integral part of financial statements as it presents key info not displayed on the face of statements

Overview of Financial Statements



Balance Sheet - Assets

Types (listed in order of liquidity):

- * Cash
- * Investments
- * Accounts Receivables
- * Restricted Assets
- * Capital Assets

Overview of Financial Statements



Balance Sheet - Liabilities

Types:

- * Cash overdrafts
- * Accounts payable
- * Accrued expenses
- * Bonds and Loans payable
- * Postemployment benefit obligations
- * Pension benefit obligations

Overview of Financial Statements



Balance Sheet – Equity (Net Worth)

Terminology Differences:

- * Sole Proprietors = Owner's Equity
- * Partnerships and LLCs = Capital Accounts
- * Corporations = Retained Earnings
- * Governments = ?

Overview of Financial Statements



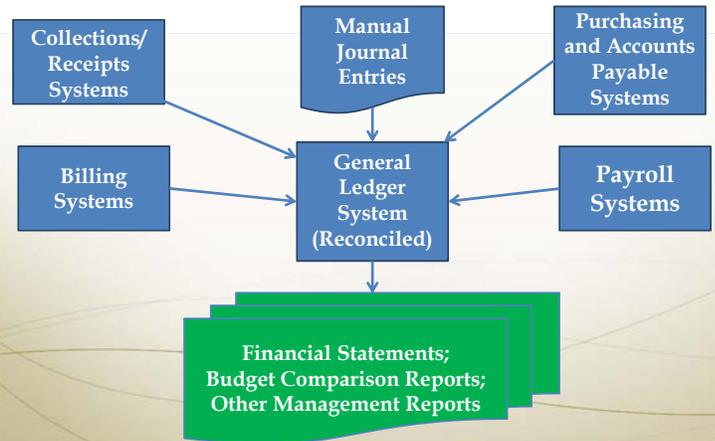
3. Who is responsible for preparing financial statements?

Management of the entity 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.

Overview of Financial Statements



4. Where does the financial information come from?



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graph TD; A[Collections/Receipts Systems] --> D[General Ledger System (Reconciled)]; B[Billing Systems] --> D; C[Manual Journal Entries] --> D; E[Purchasing and Accounts Payable Systems] --> D; F[Payroll Systems] --> D; D --> G[Financial Statements; Budget Comparison Reports; Other Management Reports];
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Overview of Financial Statements



5. What are some questions that financial statements help answer?

- * Financial Position
 - Is our financial health improving or declining?
 - What do we own? How much is owed to us?
 - What do we owe? How much is current and long-term?
- * Financial Activities
 - Does our revenue “cover” expenditures?
 - What are our other financing sources/uses (transfers in/out)?
 - What is our profit/loss amount for the period?

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Overview of Financial Statements



6. Who uses financial statements?

- * Management – To guide financial decisions
- * Bankers and Creditors – To evaluate credit worthiness and to make lending decisions
- * Stakeholders and Investors - To evaluate financial performance
- * Regulators – To evaluate financial performance, internal controls, compliance with laws and grants
- * This Audience – What value do you see in financial statements?

Overview of Financial Statements



7. How are financial statements to be used?



Overview of Financial Statements



There are three levels of financial statement services that CPAs generally provide:

1. **Audit** is the highest level of service (reasonable assurance) 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.

Overview of Financial Statements



What is main responsibility of the independent auditor?

To express an opinion on the financial statements based on an evaluation of the evidence obtained. The auditor obtains reasonable assurance and forms an opinion on whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles (GAAP).

- * The auditor expresses this opinion through a written report that also describes the basis for that opinion.

Overview of Financial Statements



To understand financial statements, it is key to know the different types of audit opinions (indicates level of assurance):

1. **Unmodified Opinion** (*clean opinion*) – financial statements are presented fairly
2. **Modified Opinions** - Three different types:
 - 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 statements 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

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Introduction to Governmental Financial Statements



Louisiana law (R.S. 24:513) generally 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: Submit to the LLA no later than six months after close of the fiscal year.

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Introduction to Governmental Financial Statements



What are some key differences in the government environment compared to private businesses?

1. Lack of profit motive
2. Legal structure and political process
3. May have the power to tax for services provided (e.g. sales/ad valorem taxes for police, roads)
4. Powers and accountability for use of funds may be defined by law (e.g., budget laws, tax proposition restrictions)
5. Unique required financial reporting (GASB establishes standards)

Introduction to Governmental Financial Statements

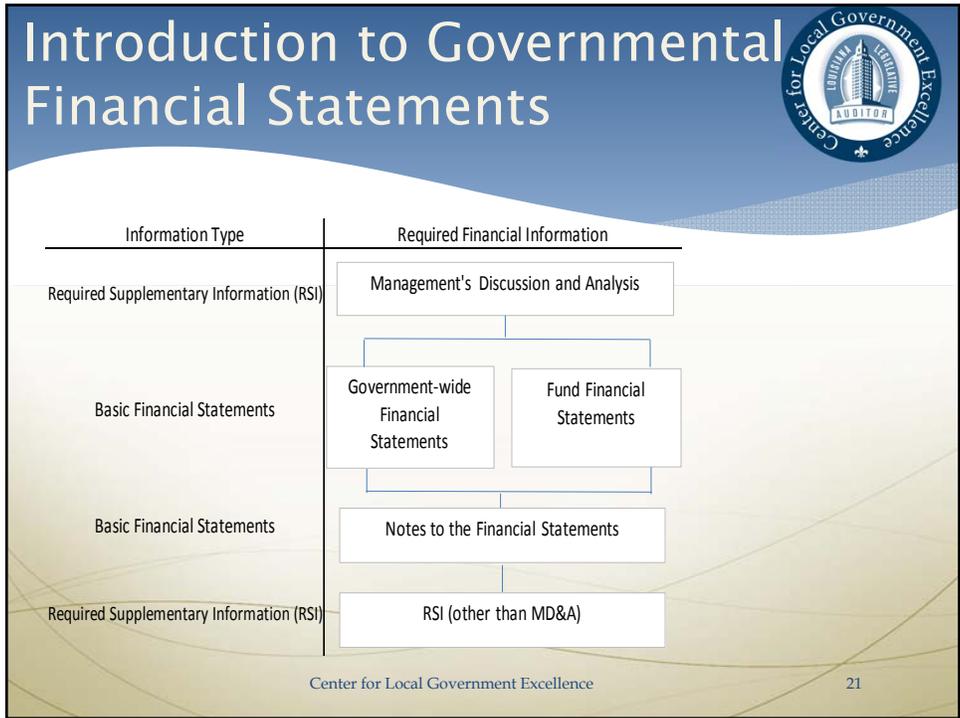


GASB 34

GASB 34 is an accounting pronouncement, issued in 1999, that made major changes to governmental accounting and reporting for state and local governments. It is designed to expand the usefulness of governmental reports to provide the total economic picture of its activities (like private businesses).

Among other changes, this financial reporting model added the following two new reporting requirements:

- * **Management's discussion and analysis (MD&A)**
- * **Government-wide financial statements**



Introduction to Governmental Financial Statements



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.

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Introduction to Governmental Financial Statements



Basic Financial Statements:

1. Government-wide Financial Statements (GWFS)
2. Fund Financial Statements (FFS)
3. Notes to the Financial Statements (NTFS)

Key differences between GWFS and FFS:

- * Financial Statement Format (e.g., Activities vs. Funds, Noncurrent vs. Current)
- * Basis of Accounting and Measurement Focus
 - * **The GWFS** (and certain FFS) **use the Full Accrual Basis of Accounting with the Economic Resources Measurement Focus.** Transactions are recorded when earned/incurred regardless of the timing of cash flows (identical to private business).
 - * **The Governmental FFS use the Modified Accrual Basis with the Current Financial Resources Measurement Focus.** Revenue recognized when measurable and available-collectible in current period or soon after to pay expenditures of the current period.

Introduction to Governmental Financial Statements



Comprehensive Annual Financial Report (CAFR)

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

Introduction to Governmental Financial Statements



The CAFR that will be used for exercises (located after slides):

City of Covington, Louisiana
For the Year Ended December 31, 2014

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Introduction to Governmental Financial Statements



CAFR (see Table of 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 (RSI) other than MD&A
 - * 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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Introduction to Governmental Financial Statements



Exercise

In the Table of Contents:

1. Locate the **FINANCIAL SECTION**
2. Locate the **BASIC FINANCIAL STATEMENTS (BFS)** section.
3. Find the BFS and label each as **#1, #2, and #3**
4. For each document listed below the BFS, write:
 - * **"SFP"** if it is a Statement showing Financial Position;
 - * **"SFA"** if it is a Statement showing Financial Activities; or
 - * **"S"** (specialized) if it is Reconciliation or Statement of Cash Flow

Government-wide Financial Statements



1. Government-wide Financial Statements (GWFS)

- * GWFS report information about the government as a whole using accounting methods similar to those used by private businesses
- * GWFS convert the fund-based financial statements (FFS) to present a long-term view of the entity's finances
- * GWFS focuses on the primary government

Government-wide Financial Statements



Government-wide financial statements are the following two statements:

- Statement of Net Position (“SFP”)
- Statement of Activities (“SFA”)
 - * 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.

Government-wide 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

Government-wide Financial Statements



Statement of Net Position (“SFP”)

Components are presented by activities [in separate columns]

Accounting Equation:

Assets

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

= Liabilities

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

+ **Net Position** [categories: Invested in Capital Assets; Restricted; Unrestricted]

Government-wide Financial Statements



Statement of Activities (“SFA”)

Components are presented by Functions/Programs [within the Governmental and Business-type Activities]

Accounting Equation:

Expenses

- **Program Revenues**

= Net (Expense) Revenue

+ General Revenues

= **Change in Net Position**

+ Net Position at beginning of year

= Net position at end of year

Government-wide Financial Statements



Exercise

Government-wide Financial Statements

Fund Financial Statements



2. Fund Financial Statements (FFS)

- * The accounts of the entity are organized and presented on the basis of funds (not activities)
- * A fund is a fiscal and accounting entity with a self-balancing set of accounts (assets, liabilities, equity) from which financial statements can be prepared
- * Focus is on accountability and on the major funds
- * One column for all non-major funds combined

Fund Financial Statements



There are three categories of Fund Financial Statements (FFS):

(Individual funds are grouped into one of these categories)

1. **Governmental Fund** comprises funds that are used to account for governmental-type activities. Focus is on sources, uses, and balances of current financial resources and often has a budgetary orientation.
2. **Proprietary Fund** comprises funds that are used to account for business-type activities (similar to private sector businesses) which are managed with a long-term prospective. Focus is on determination of operating income, changes in net position, and cash flows.
3. **Fiduciary Fund** comprises funds used to account for assets that are being held for the benefit of others (e.g., employees' retirement system)

Fund Financial Statements



Governmental Fund financial statements are prepared for:

- * **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

Fund Financial Statements



Governmental Funds are reported in two fund financial statements:

1. Balance Sheet (“SFP”)
2. Statement of Revenues, Expenditures, and Changes in Fund Balances (“SFA”)

Fund Financial Statements



1. Balance Sheet (“SFP”)

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

Accounting Equation:

Assets

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

= **Liabilities**

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

+ **Fund Balance** *[a good measure of financial position]*



Fund 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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Fund Financial Statements

2. Statement of Revenues, Expenditures, and Changes in Fund Balances ("SFA")

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

Accounting Equation:

- Revenues**
- **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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Fund Financial Statements



There are also two summary reconciliations that are required to be prepared and presented:

- 1. Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Position** [reconciles total governmental fund balances to net position of governmental activities]
- 2. Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities** [reconciles the total change in governmental fund balances to the change in net position of governmental activities]

Fund Financial Statements



Exercise

Governmental Funds Financial Statements

Fund Financial Statements



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., utility system).
- * **Internal Service funds** which are used to account for “internal” activities that provide service to other departments (e.g., motor pools, in-house print shops)

Fund Financial Statements



Proprietary Funds are reported in three fund financial statements:

1. Statement of Net Position (“SFP”)

Accounting Equation:

Assets
= Liabilities
+ Net Position

Fund Financial Statements



2. Statement of Revenues, Expenses, and Changes in Net Position ("SFA")

Accounting Equation:

- Operating **Revenues**
- Operating **Expenses**
- = Operating **Income (Loss)**
- +/- **Nonoperating** Revenue (Expenses)
- = **Changes in Net Position**
- + Net Position at beginning of year
- = Net Position at end of year

Fund Financial Statements



3. Statement of Cash Flows ("S")

Accounting Equation:

- Cash Flows from **Operating** Activities (e.g., receipts from customers)
- +/- Cash Flows from **Noncapital Financing** Activities (e.g., transfers in)
- +/- Cash Flows from **Capital and Related Financing** Activities (e.g., loan)
- +/- Cash Flows from **Investing** Activities (e.g., interest)
- = **Net increase (decrease) in cash** and cash equivalents
- + Cash and cash equivalents at beginning of year
- = Cash and cash equivalents at end of year



Fund Financial Statements

Exercise

Proprietary Fund Financial Statements

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Fund Financial Statements

Summary:

Fund Categories	Governmental	Proprietary	Fiduciary
Fund Types	<ol style="list-style-type: none"> 1. General Fund 2. Special Revenue Funds 3. Capital Projects Funds 4. Debt Service Funds 5. Permanent Funds 	<ol style="list-style-type: none"> 1. Enterprise Funds 2. Internal Service Funds 	<ol style="list-style-type: none"> 1. Pension Trust Funds 2. Investment Trust Funds 3. Private-Purpose Trust Funds 4. Agency Funds
Measurement Focus/Basis of Accounting	Current Financial Resources/Modified Accrual	Economic Resources/Full Accrual	Economic Resources/Full Accrual
Required Financial Statements	<ul style="list-style-type: none"> • Balance Sheet • Statement of Revenues, Expenditures, and Changes in Fund Balances 	<ul style="list-style-type: none"> • Statement of Net Position • Statement of Revenues, Expenses, and Changes in Fund Net Position • Statement of Cash Flows 	<ul style="list-style-type: none"> • Statement of Fiduciary Net Position • Statement of Changes in Fiduciary Net Position

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Notes to the 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)

Notes to the Financial Statements



Exercise

Notes to the Financial Statements

Required and Other Supplementary Information



- 1. Required Supplementary 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.
 - * Budget to Actual Schedules (for General and Special Revenue Funds)
 - * Non-major funds
- 2. Other Supplementary Information** includes:
 - * Schedule of Board/Council Compensation
 - * Schedule of Compensation, Benefits and Other Payments to Agency Head

Required and Other Supplementary Information



Exercise

- * **Required Supplementary Information** (other than MD&A)
- * **Other Supplementary Information**

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

Reports Required by *Government Auditing Standards*



Exercise

Reports Required by *Government Auditing Standards*

Additional Resources



1. [GASB](#) (Governmental Accounting Standards Board)
2. [GFOA](#) (Government Finance Officers Association)
3. [AICPA](#) (American Institute of Certified Public Accountants)
4. [LCPA](#) (Society of Louisiana Certified Public Accountants)
5. [LLA](#) (Louisiana Legislative Auditor)

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Additional Resources



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