

**Date**

March 8, 2017

**Time**

1:15 pm – 3:00 pm

**Instructor**

Eric Sloan, CPA  
LLA Advisory Services Manager

**Location**

New Orleans, LA

**Method of Delivery**

Classroom instruction

**Learning Level**

Basic

**CPE Hours**

2.0 Hours

**CPA Subject Matter**

Accounting and Auditing

**Prerequisite**

None

# 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
- Key components of financial statements
- Basic financial statement terminology
- How to read and understand financial statements

**Who Will Benefit**

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


**About the Instructor**

Eric Sloan has been a CPA for more than 30 years and has been working at the LLA for the past 17 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

Daryl G. Purpera, CPA, CFE  
Louisiana Legislative Auditor

Presented by:  
Eric Sloan, CPA  
Advisory Services Manager

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Learning Objective




## To make governmental financial statements more user friendly and understandable

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# Agenda



Slides	Topics
4 - 18	Basics of Financial Statements
19 - 53	Understanding Governmental Financial Statements
54	LLA Resources

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# Basics of Financial Statements



1. What is a financial statement?
2. What key information is in financial statements?
3. Who is responsible for preparing 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 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.

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# Basics of Financial Statements



## 2. What key information is in financial statements?

- \* **Financial Position:**  
What you own, what you owe, and what is left over at a specific point in time.
- \* **Financial Activities:**  
What are the revenues, what are the expenses, and what is the net profit or net loss over a period of time.

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# Basics of Financial Statements

## Financial Position: Assets

Types (listed in order of liquidity):

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

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# 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.)
- \* Bonds payable
- \* Net pension liability (retirement)
- \* Net other post-employment benefit obligations (healthcare)

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# Basics of Financial Statements

## Financial Position: Equity

Terminology

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

[Note: **Equity is an indicator of financial health** – is the government spending within its means]

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# Basics of Financial Statements

## 3. Who is responsible for preparing financial statements?

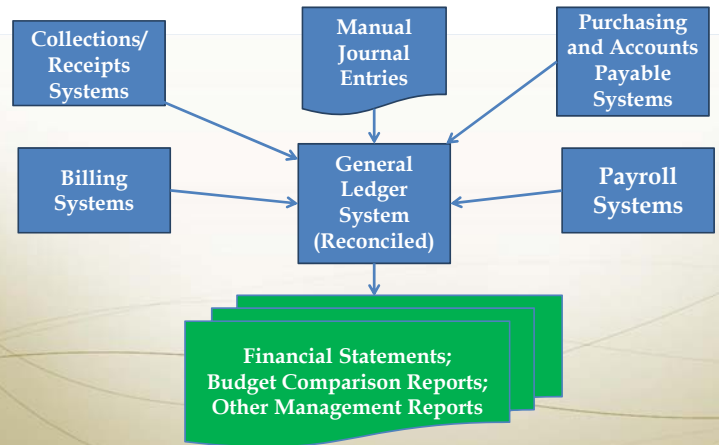
Management of the entity is responsible for the preparation and fair presentation of the financial statements, **including** the design, implementation, and maintenance of **internal controls** relevant to their preparation and fair presentation.

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## Basics of Financial Statements




### 4. Where does the financial information come from?



```
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];
```

## Basics of Financial Statements




### 5. Who uses financial statements?

- \* 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?**



```

    graph TD
      Planning((Planning)) --> Budgeting((Budgeting))
      Budgeting --> MonthlyMonitoring((Monthly Monitoring))
      MonthlyMonitoring --> AuditedReport((Audited Annual Financial Report))
      AuditedReport --> Assessment((Assessment of Financial Stability))
      Assessment --> Planning
  
```

## Basics of Financial Statements

**CPAs provide three levels of 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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# Basics of Financial Statements

## What is primary responsibility of CPA/Auditor?

- \* To obtain and evaluate evidence to form an opinion on whether the financial statements are presented fairly in all material respects in conformity with Generally Accepted Accounting Principles (GAAP). [GAAP governs the format and contents of financials which allows for comparability across the country.]
- \* To express his/her opinion on the financial statements in a written report that also describes the basis for that opinion.

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# Basics of Financial Statements

## To know if the financial statements you are looking at are fairly presented, you need to find out what type of opinion was given by the auditor:

1. **Unmodified Opinion** – 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.

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## Basics of Financial Statements



### 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

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## Basics of Financial Statements



### What is GAAP?

Generally Accepted Accounting Principles are financial reporting rules for the accounting profession to follow to ensure that there is consistency and comparability in reporting.

### What is Materiality?

The threshold amount above which missing or incorrect information in financial statements is considered to have an impact on the decision-making of users.

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# 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




**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 governments, the accounting industry, and the capital markets as the official source of generally accepted accounting principles (GAAP) for state and local governments.

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# Governmental Financial Statements




## Measurement Focus and Basis of Accounting - Summary

	Financial Statements	Measurement Focus ( <u>what</u> accounts to report)	Basis of Accounting ( <u>when</u> rev. and exp. are reported)
A.	<b>Private Business</b> statements	Economic resources	Full Accrual
B.	<b>Local and State Government:</b>		
	Government-wide statements	Economic resources	Full Accrual
	Governmental fund statements	Current financial resources	Modified Accrual
	Proprietary fund statements	Economic resources	Full Accrual
	Fiduciary fund statements	Economic resources	Full Accrual

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# 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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# 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
  - \* **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
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



**Fund Financial Statements** are prepared for:

1. **Governmental Funds** - report revenue and expenditures of general operations
2. **Proprietary Funds** - report revenue and expenses of business-like activities that are supported, in part, by fees or charges (similar to business)
3. **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:**

	Governmental	Proprietary	Fiduciary
<b>Fund Types</b>	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
<b>Measurement Focus/Basis</b>	Current Financial Resources/ Modified Accrual	Economic Resources/ Full Accrual	Economic Resources/ Full Accrual
<b>Required Financial Statements</b>	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




**1. 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



**Governmental Funds are reported in the following two Financial Statements:**

- A. Balance Sheet
- B. Statement of Revenues, Expenditures, and Changes in Fund Balances

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# Governmental Financial Statements



## A. Balance Sheet

[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/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



## B. Statement of Revenues, Expenditures, and Changes in Fund Balances

[Presented by each major governmental fund and the total of non-major 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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# Governmental Financial Statements




## Exercise

### Governmental Funds - Financial Statements

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# Governmental Financial Statements



**2. 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, landfill).
- \* **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) for reimbursement.

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# Governmental Financial Statements



**Proprietary Funds** are reported in three financial statements:


**A. Statement of Net Position**

Accounting Equation:

- Assets
- = Liabilities
- + Net Position

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# Governmental Financial Statements




## B. Statement of Revenues, Expenses, and Changes in Net Position

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

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# Governmental Financial Statements




## C. Statement of Cash Flows

Accounting Equation:

- Cash Flows from **Operating** Activities (e.g., receipts from customers)
- +/- Cash Flows from **Non-Capital 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

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# Governmental Financial Statements




Exercise

## Proprietary Funds - Financial Statements

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# Governmental Financial Statements



## 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

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# 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.

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# 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

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# Governmental Financial Statements



## Statement of Net Position

[Components are presented by type of activity - Governmental and Business-type]

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** [components include amounts invested in capital assets; restricted amounts; and unrestricted amounts (a good measure of financial position/health)]

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# Governmental Financial Statements



## Statement of Activities

[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**

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# Governmental Financial Statements



There are also two summary reconciliations that are required to be prepared and presented with the Basic Financial Statements:

- 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]

# Governmental Financial Statements




## Exercise

## Government-wide Financial Statements



# 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)

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# Governmental Financial Statements



Exercise

## Notes to the Financial Statements

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# 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).

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# 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)

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# 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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# LLA Resources



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