

**Date**

August 10, 2016

**Time**

8:00 am – 9:50 am

**Instructor**

Eric Sloan, CPA  
LLA Advisory Services Manager

**Location**

Monroe, LA

**Method of Delivery**

Classroom instruction

**Learning Level**

Basic

**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 certified public accountant for 31 years and has been with the LLA for 16 years. Eric currently serves as a Manager in the Advisory Services section of the LLA. Before coming to the LLA, Eric worked in a CPA firm for 16 years and served 2 years as controller of a multi-state engineering company.

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

August 2016

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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
4-17	Overview of Financial Statements
18-27	Introduction to Governmental Financial Statements
28-33	Government-wide Financial Statements (GWFS)
34-48	Fund Financial Statements (FFS)
49-50	Notes to the Financial Statements (NTFS)
51	Required and Other Supplementary Information
52	Reports Required by <i>Government Auditing Standards</i>

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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 questions do financial statements help answer?
6. Who uses financial statements and why?
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.

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# 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

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# Overview of Financial Statements



## Balance Sheet: Assets

Types (listed in order of liquidity):

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

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# Overview of Financial Statements



## Balance Sheet: 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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# Overview of Financial Statements



## Balance Sheet: Equity

Terminology Differences

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

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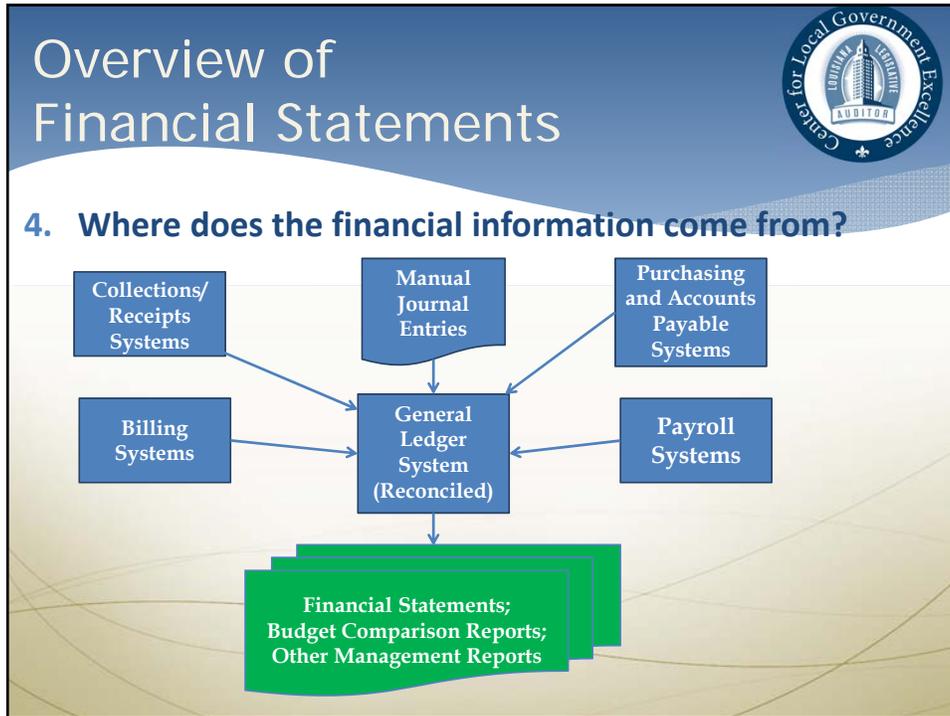
# Overview of Financial Statements



## 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.

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## Overview of Financial Statements



**5. What questions do financial statements help answer?**

- \* Financial Position
  - Is our financial health improving or declining?
  - Assets: What do we own? How much is owed to us?
  - Liabilities/Obligations: What do we owe? How much is owed currently and how much is owed down the road (long term)?
- \* Financial Activities
  - Does our revenue “cover” our 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 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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# Overview of Financial Statements



## 7. How are financial statements to be used?



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graph TD; Planning --> Budgeting; Budgeting --> MonthlyMonitoring[Monthly Monitoring]; MonthlyMonitoring --> AuditedAnnual[Audited Annual Financial Report]; AuditedAnnual --> Assessment[Assessment of Financial Condition]; Assessment --> Planning;
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## 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

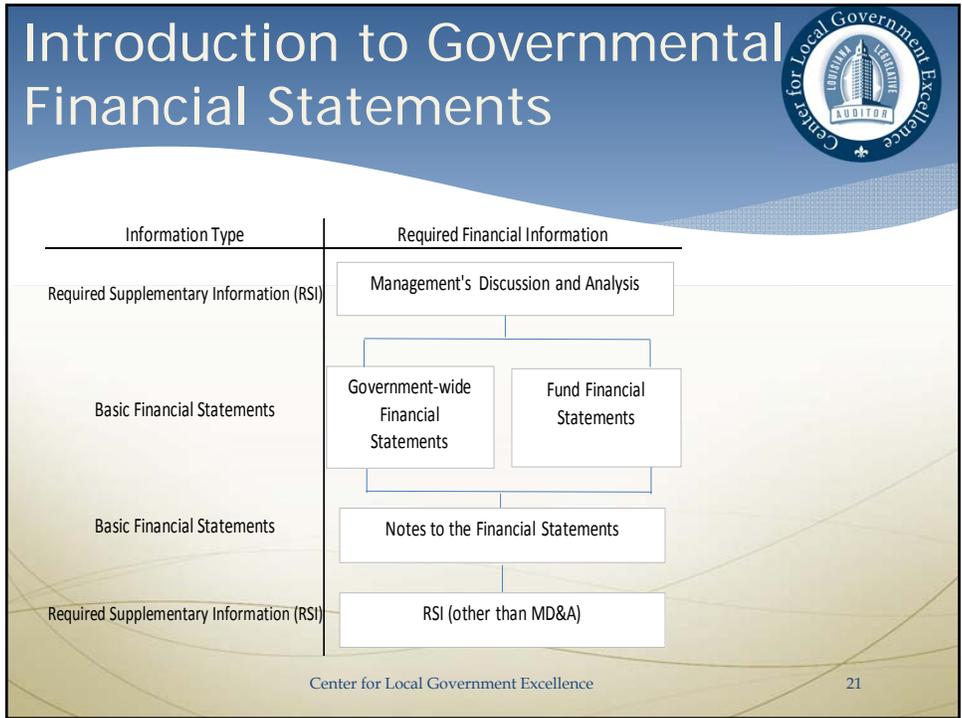


## GASB 34

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:

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

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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

**Basic Financial Statements** consists of (see Table of Contents):

- \* Three Statements that show **Financial Position**
- \* Three Statements that show **Financial Activities**
- \* One Statement that shows Cash Flows
- \* Two Reconciliations of Governmental Funds Financial Statements to the Government-wide Financial Statements
- \* Notes to the Financial Statements

# 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
- 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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## 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

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# Government-wide Financial Statements



## Statement of Net Position

Below components are presented by type of activity [Governmental Activity and Business-type Activity]

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]

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# Government-wide 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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# 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).

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# 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

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# Fund Financial Statements

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

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

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# Fund Financial Statements

## 1. 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]*

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# 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

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 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]

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# Fund Financial Statements



Exercise

## Governmental Funds Financial Statements

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# 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)

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# Fund Financial Statements



Proprietary Funds are reported in three fund financial statements:

- 1. Statement of Net Position**  
Accounting Equation:  
Assets  
= Liabilities  
+ Net Position

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# Fund Financial Statements



## 2. 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

# Fund Financial Statements



## 3. 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



# 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"> <li>1. General Fund</li> <li>2. Special Revenue Funds</li> <li>3. Capital Projects Funds</li> <li>4. Debt Service Funds</li> <li>5. Permanent Funds</li> </ol>	<ol style="list-style-type: none"> <li>1. Enterprise Funds</li> <li>2. Internal Service Funds</li> </ol>	<ol style="list-style-type: none"> <li>1. Pension Trust Funds</li> <li>2. Investment Trust Funds</li> <li>3. Private-Purpose Trust Funds</li> <li>4. Agency Funds</li> </ol>
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"> <li>• Balance Sheet</li> <li>• Statement of Revenues, Expenditures, and Changes in Fund Balances</li> </ul>	<ul style="list-style-type: none"> <li>• Statement of Net Position</li> <li>• Statement of Revenues, Expenses, and Changes in Fund Net Position</li> <li>• Statement of Cash Flows</li> </ul>	<ul style="list-style-type: none"> <li>• Statement of Fiduciary Net Position</li> <li>• Statement of Changes in Fiduciary Net Position</li> </ul>

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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

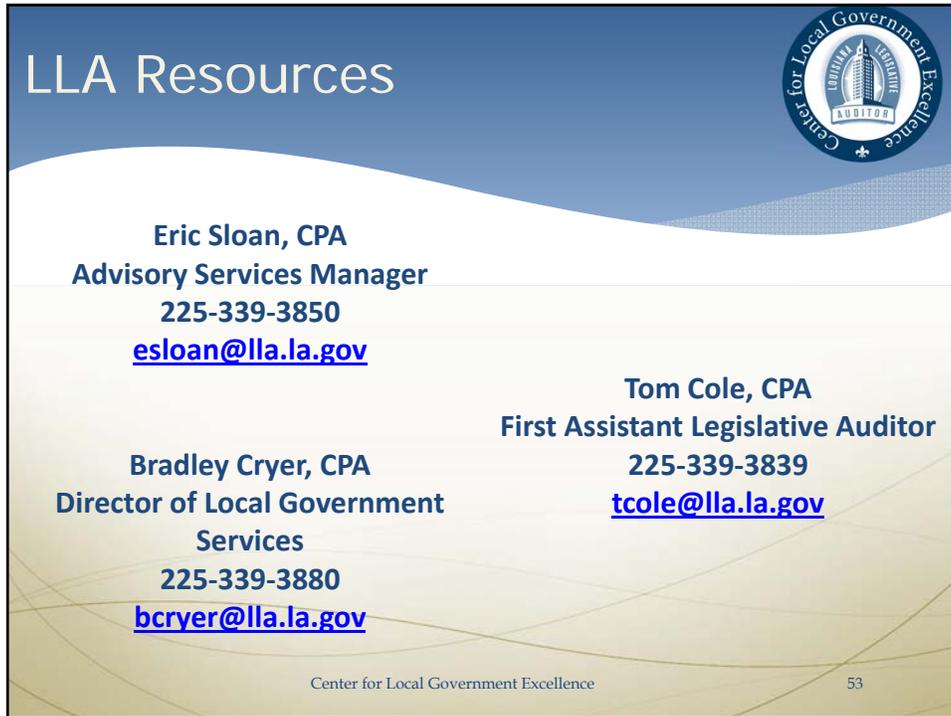


1. **Required Supplementary Information** other than MD&A includes schedules, statistical data, and other information that are an essential part of financial reporting that should be presented with, but are not part of, the basic financial statements.
  - \* **Budget to Actual Schedules** (for General and Special Revenue Funds)
2. **Other Supplementary Information** includes:
  - \* Financial Statements of Non-Major Governmental Funds
  - \* Schedule of Board/Council Compensation
  - \* Schedule of Agency Head's Compensation, Benefits and Other Payments

## 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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