Financial Reporting of State and Local Governments
Learning Objectives

After studying Chapter 9, you should be able to:

- Describe the concepts related to the financial reporting requirements of the GASB reporting model
- Explain the key concepts and terms used in describing the governmental reporting entity
- Apply the GASB criteria used to determine whether a potential component unit should be included in the reporting entity and, when included, manner of reporting component units
Learning Objectives (Cont’d)

- Identify and describe the contents of a comprehensive annual financial report (CAFR)
- Understand how to reconcile governmental fund financial statements to governmental activity in the government-wide financial statements
- Identify and explain contemporary financial reporting issues
Concepts of Financial Reporting

- Two primary objectives of government financial reports
  - To provide information that can be used to assess accountability
  - To assist users in making economic, social, and political decisions

- Characteristics of useful information are understandability, reliability, relevance, timeliness, consistency, and comparability
Effective communication improves the usefulness of government financial reports

The information appearing in government financial reports must meet the definition of one of the elements defined by GASB

- Assets
- Deferred outflows of resources
- Deferred inflows of resources
- Net position

- Liabilities
- Outflows of resources
- Inflows of resources
The **reporting entity** consists of the primary government and all component units for which the primary government is financially accountable.

Most **component units** are reported by discrete (separate column) presentation, rather than blending the component unit’s financial information with the appropriate fund columns of the primary government.
A primary government is financially accountable for another organization if it appoints a voting majority of the organization’s governing board and it can either

- Impose its will on that organization or
- Potentially provide specific financial benefits to or impose a financial burden on the other organization.
Even if it does not appoint a majority of an organization’s governing board, the primary government (PG) is financially accountable for another organization if either:

- The other organization is fiscally dependent on the PG, or
- It holds economic resources entirely or almost entirely for the PG, the PG is entitled to or has the ability to access a majority of the economic resources being held by the other organization, and the resources being held are significant to the PG.
Citizens and others (e.g., creditors and legislators) have a need for periodic reports on the sources of the government’s resources and how the resources were used.

Interim financial reports are needed as well as annual reports for sound internal management and legislative oversight.
The major sections of a comprehensive annual financial report (CAFR) are the

- Introductory section
- Financial section
- Statistical section
CAFR (Cont’d)

Introductory Section

- Title page
- Contents page
- Letter of transmittal
- Other (as desired by management)
Financial Section

- Auditor’s report
- MD&A
- Basic financial statements
- Required supplementary information (RSI) other than MD&A, including the budgetary comparison schedule
- Combining and individual fund financial statements
CAFR (Cont’d)

Statistical Section

- Financial trends information
- Revenue capacity information
- Debt capacity information
- Demographic and economic information
- Operating information
General Purpose
External Financial Reports

Management’s discussion and analysis

Government-wide financial statements

Fund financial statements

Notes to the financial statements

Required supplementary information (other than MD&A)
Basic Financial Statements

- Government-wide financial statements
  - Statement of net assets (III. A1-1 and 9-3)
  - Statement of activities (III. A1-2 and 9-4)
- Fund financial statements (see next 3 slides)
- Notes to the financial statements
Fund Financial Statements—Governmental Funds

- Balance sheet—governmental funds (Ill. A1-3 and 9-5) with reconciliation (Ill. A1-4 and 9-7)

- Statement of revenues, expenditures, and changes in fund balances—governmental funds (Ill. A1-5 and 9-6) with reconciliation (Ill. A1-6 and 9-8)
Fund Financial Statements—Proprietary Funds

- Statement of net assets—proprietary funds (III. A1-7)
- Statement of revenues, expenses, and changes in fund net assets—proprietary funds (III. A1-8)
- Statement of cash flows—proprietary funds (III. A1-9)
Fund Financial Statements—Fiduciary Funds

- Statement of fiduciary net assets (Ill. A1-10)
- Statement of changes in fiduciary net assets (Ill. A1-11)
Financial Reporting Model

Government-wide financial statements:

- Entity-wide perspective
- Long-term focus on operational accountability
- All governmental and business-type activities of the government as a whole are reported on the accrual basis—essentially the same as for-profit entities
Preparation of the government-wide financial statements at year-end requires:

- Adjusting entries to record items such as annual depreciation and accrual of interest receivable and payable
- Entries to close all program and general revenues and expenses
- Entries to reclassify, as necessary, Net Assets—Unrestricted to Net Assets—Restricted (various purposes) and Net Assets—Invested in Capital Assets, Net of Related Debt
Fund financial statements:

- Short-term focus on fiscal accountability
- Most activities of the government are reported on the modified accrual basis; however, proprietary funds are reported essentially the same as for-profit entities
- Information on the governmental fund financial statements must be reconciled to information reported in the Governmental Activities column on the government-wide statements
Many accounting professionals, politicians, and others believe current governmental financial statements are excessively complex and not understandable except to those knowledgeable about governmental accounting.

Some governments provide simplified, summary reports called “popular reports.”

Graphical presentation is used to a greater extent than traditional financial statements.
Current Issues (Cont’d)

Other comprehensive basis of accounting (OCBOA)

- Not all governments maintain internal records on a GAAP basis, many use OCBOA
- Types of OCBOA most commonly used by governments include—cash basis, modified cash basis, and regulatory basis
- Many reasons are provided for using OCBOA, including cost and ease of use
- Use of OCBOA does not preclude the need to present information similar to that reported under GAAP
Current Issues (Cont’d)

International Accounting Standards
- As with FASB, GASB has an international counterpart
- International Public Sector Accounting Standards (IPSAS) are issued by the International Public Sector Accounting Standards Board (IPSASB)
- IPSASB are used by over 60 countries
Concluding Comments

- The financial reporting model requires each financial reporting entity to prepare at a minimum: MD&A; basic financial statements (government-wide and fund); notes to the financial statements; required supplementary information, other than MD&A.

- It is recommended that each reporting entity prepare as its official financial record a comprehensive annual financial report (CAFR).

- As the financial needs of users continue to change, so will financial reporting standards.

END