



# Financial Reporting: The Basic Financial Statements & Required Supplementary Information



## Chapter 13

# Learning Objectives

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- Identify a government's basic financial statements
- Understand format and content of government-wide financial statements and fund financial statements
- Understand the concept and content of RSI
- Identify a government's major funds and how to prepare fund financial statements
- Distinguish program revenues from general revenues
- Understand unique reporting provisions of infrastructure capital assets
- Understand required information components of MD&A
- Understand types of notes to financial statements
- Understand reporting requirements of special purpose governments

# Major Elements of Principle #13

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- Interim financial statements & reports
- Comprehensive Annual Financial Report (CAFR)
- Minimum reporting requirements
  - MD&A
  - Basic Financial Statements (BFS)
  - Required Supplementary Information
- Financial reporting entity
- Nucleus of a financial reporting entity

# Interim Financial Statements

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- Encouraged, but not required
- Prepared to facilitate management's control of the government, legislative oversight, and [occasionally] external financial reporting

# Comprehensive Annual Financial Report

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- Should be prepared and published
- Covers primary government (including blended component units) and discretely presented component units
- Includes:
  - Introductory Section
  - Financial Section
  - Statistical Section

# Financial Reporting Entity

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Consists of

- Primary Government
- Organizations for which the primary government is financially responsible
- Other organizations whose exclusion from the report would cause it to be misleading or incomplete

# Reporting Entity's Financial Statements

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- Government-Wide Financial Statements
  - Provide information about the reporting government as a whole
  - Distinguish between primary government (composed of Governmental Activities & Business-Type Activities) and discretely presented component units
- Fund Financial Statements
  - Present primary government's major funds individually and nonmajor fund in aggregate
  - Funds and component units that are fiduciary in nature reported only at this level

# Nucleus of Financial Reporting Entity

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- Usually a primary government
- Other entities can serve as nucleus of own reporting entity, even when related to a primary government
- Financial reports built from the bottom up, applying all definition and display provisions to each level before rolling up to next level



# Focus of this Chapter

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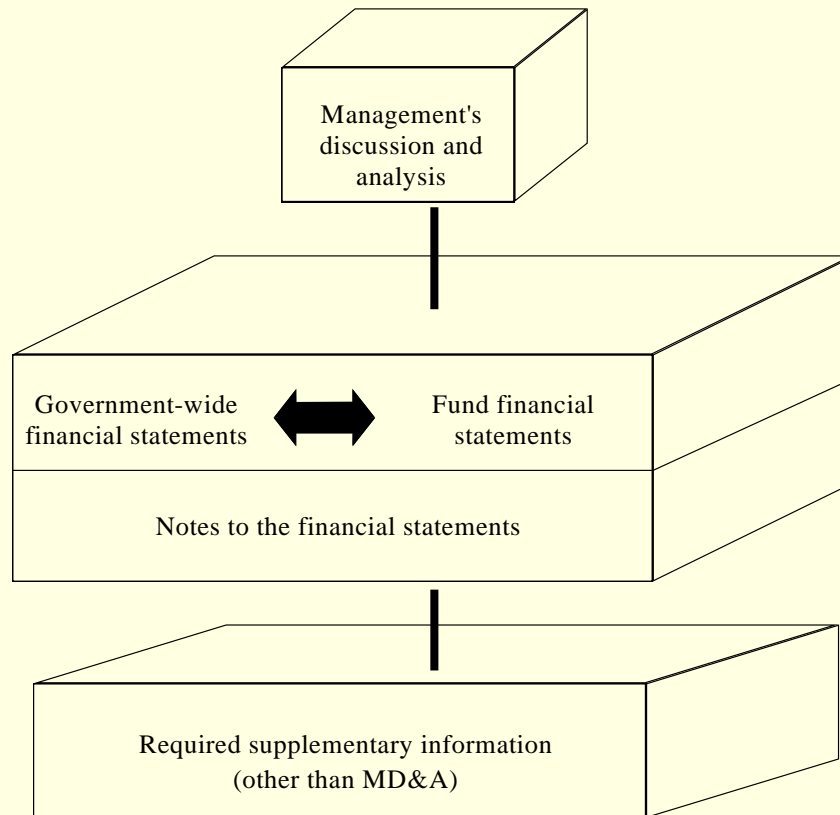
- Minimum requirements for financial reporting, which are the MD&A, basic financial statements, and other RSI
- Some governments may be required to present a CAFR – topic of Chapter 15

# What makes up the minimum report?

## GASB Statement #34

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### Minimum Requirements for General Purpose External Financial Reporting



# Basic Financial Statements Overview

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- Government-Wide Financial Statements
  - Statement of Net Assets
  - Statement of Activities
- Governmental Funds Financial Statements
  - Balance Sheet
  - Statement of Revenues, Expenditures, and Changes in Fund Balances (GAAP basis)
  - Statement of Revenues, Expenditures, and Changes in Fund Balances – Budget and Actual

# BFS Overview (continued)

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- Proprietary Funds Financial Statements
  - Statement of Net Assets (Balance Sheet)
  - Statement of Revenues, Expenses, and Changes in Net Assets
  - Statement of Cash Flows
- Fiduciary Funds Financial Statements
  - Statement of Fiduciary Net Assets
  - Statement of Changes in Fiduciary Net Assets
- Notes to the financial statements

# Fund Financial Statements

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- Major fund statements prepared for
  - Governmental Funds
  - Enterprise Funds
- Fund type statements prepared for
  - Internal Service Funds
  - Fiduciary Funds

# Major Fund Reporting: Governmental Funds [Pages 511–514]

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- Separate column for
  - General Fund
  - Each major fund
  - Aggregate column for all nonmajor funds
- Total column required
- Reconciliations required
  - Fund Balance to Net Assets [Bottom of page 511]
  - Change in Fund Balance to Change in Net Assets [Page 513]

# Major Fund Reporting:

## Proprietary Funds [Pages 515–517]

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- Separate column for each major Enterprise Fund
- Enterprise Funds Total column required
- Single column for all ISFs
- Proprietary Total column may be prepared but does not tie to other financial statements

# Identifying Major Funds

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- General Fund is always a major fund
- Other major funds may change from year-to-year
- Any Governmental Fund or Enterprise Fund must be a major fund if both these tests are passed:
  - Total assets, liabilities, revenues, or expenditures/ expenses (excluding extraordinary items or special items) are at least 10% of the corresponding total for all funds of that category or type
  - The same element that met the 10% test above is at least 5% of the corresponding element total for all Governmental Funds and Enterprise Funds combined
- Other funds not passing these tests can be reported as major at the option of the government



# Steps for Major Fund Calculations

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1. List all Governmental Funds and Enterprise Funds
2. Gather required information for each fund:
  - Total Assets
  - Total Liabilities
  - Total Revenues
  - Total Expenditures / Expenses, as appropriate
3. Divide each element by applicable total for 10% and 5% tests
4. Major funds are ones where same element passes both tests
5. Sample shown in 13-1 **IN PRACTICE** [Page 519]

# Fund-Type Reporting [Pages 522–523]

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- Used for Fiduciary Funds
- Separate column for each type of Fiduciary Fund
  - Pension Trust Funds
  - Investment Trust Funds
  - Private Purpose Trust Funds
  - Agency Funds (on Statement of Fiduciary Net Assets only)
- Total column allowed but does not tie to other financial statements

# Notes on Governmental Funds Balance Sheet

[Found on page 511]

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- Major funds reported in separate columns
- All other funds aggregated in a single column (combining statements included elsewhere in the CAFR but not part of BFS)
- Total column required by GAAP
- GCA and GLTL not reported in fund statements
- Reservations of fund balance must be in sufficient detail to be understood
- If non-major funds have Unreserved Fund Balance, it must be reported by fund types

# Notes on Governmental Funds Operating Statement [Found on page 512]

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- Same major fund format as found with Balance Sheet
- Standard format used – same format demonstrated in Chapter 2 through 8

# Notes on Governmental Funds Budgetary Comparison Statement [Found on page 514]

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- Required for General Fund and all major SRFs with legally adopted budgets
- 3 columns required: (1) original budget, (2) final budget, and (3) actual amounts on a budgetary basis
- Variance column is optional, although most governments present it
- Format need **not** be the same as operating statement
- Statement may be presented as part of BFS or in RSI as a schedule
- Actual amounts on budgetary basis must be reconciled to GAAP basis

# Government-Wide Financial Statements: Common Features

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- Distinguish between primary government and discretely presented component units
- Focus is on the primary government
- Distinguish between primary government's Governmental Activities and Business-Type Activities
- Present a total column for the primary government
- Apply same accounting standards to Governmental Activities and Business-Type Activities
- Exclude Fiduciary Funds and fiduciary component units

# Governmental Activities

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- Financed primarily through
  - Taxes
  - Intergovernmental revenues
  - Other nonexchange revenues
- Generally reported in Governmental Funds and, maybe, Internal Service Funds
- Most general capital assets and general long-term liabilities reported here
- Activities include general administration, public safety, education, streets & roads, and health & sanitation

# Business-Type Activities

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- Financed in whole or in part by fees charged to external users for goods and services
- Generally reported in Enterprise Funds, although ISFs can be here, too
- Activities may include public utilities, mass transportation, landfills, airports, and some recreational facilities



# Statement of Net Assets [Page 525]

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- Generally same format as used by Proprietary Funds
- May use either balance sheet format or net asset format
- May or may not be classified
- Columns may include
  - Governmental Activities
  - Business-Type Activities
  - Primary Government Total Column (required if both GA and BTA present)
  - Discretely presented Component Units (one or more columns)
  - Reporting Entity Total Column is optional

# Key Features of Statement

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- Assets & liabilities presented in order of relative liquidity (unless classified)
- Capital assets should be reported either
  - Single line item or distinguish between depreciable and nondepreciable assets
  - Major classes of assets
- Liabilities with average maturities of more than one year must be reported separate from current liabilities

# Key Features of Statement (continued)

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- General capital assets included in Governmental Activities column
- Infrastructure capital assets reported using modified approach should be reported separately
- General long-term liabilities reported in Governmental Activities column
- Interfund payables and receivables between Governmental Funds have been eliminated – same is true for Enterprise Fund receivables and payables

# Key Features of Statement (continued)

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- Internal balances between Governmental Activities and Business-Type Activities are net receivable and payable amounts – eliminated when preparing total column
- Net Assets presented in three components
  - Invested in Capital Assets, Net of Related Debt
  - Restricted – distinguish between major categories of restrictions
  - Unrestricted

# Statement of Activities [Page 530]

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Intended to present

- Cost of providing services by function
- Related program revenues derived from each function
- Net burden that each function places on taxpayers and other providers of general revenues
- Sources from which the net cost of the government's activities are financed

# Statement of Activities Presentation

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- Three sets of columns
  - Expenses
  - Program Revenues
  - Net (Expense) Revenue and Changes in Net Assets – these mirror columns found on Statement of Net Assets
- Upper portion of statement reports
  - Expenses (of a particular function)
  - Program Revenues (of the function)
  - Net (Expense) Revenue (of the function)

# Statement of Activities Presentation

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Each function or program shown on a separate line with separate sections for

- Governmental Activities – minimum level of detail derived from Statement of Revenues, Expenditures, and Changes in Fund Balance Current (Operating) Expenditures section
- Business-Type Activities – minimum level is by identifiable activity
- Component Units – usually reported on one line but may report by major component unit

# MFBA – important features

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- MFBA
  - Measurement focus – economic resources
  - Basis of Accounting – accrual
- Expenses not found on Governmental Fund operating statement reported on Statement of Activities
  - Capital outlay expenditures replaced by depreciation expense
  - Debt service principal payments not reported on Statement of Activities
  - Interest expenditure become interest expense – much broader measure
  - Compensated absences, claims and judgments, & pension liabilities not shown as expenditures on fund statements become expenses on this statement



# Reporting Expenses

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- Reporting direct expenses by function is the minimum requirement for Statement of Activities
- May allocate indirect expenses among functions – requires use of a separate column (rarely used)
- Interest Expense generally reported as a separate line [function] but may be as a direct expense if certain requirements are met
- General rules for reporting Depreciation Expense
  - Direct expense of function responsible for related asset
  - Infrastructure depreciation direct expense of function responsible for maintaining it
  - Depreciation on asset used by all functions need not be allocated

# Program Revenues vs. General Revenues

[See Illustration 13-13 on page 533]

- Program Revenues generally classified as:
  - Charges for Services
  - Program-specific Operating Grants & Contributions
  - Program-specific Capital Grants & Contributions
- May change columnar titles, if appropriate
- General Revenues include
  - All taxes
  - Other revenues not restricted to particular programs

# Charges for Services

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- Charges for services always reported as program revenues
- Charges for services should be reported in function that generated the revenues, even if used by a different program
- All other program revenues reported with function to which use is restricted

# Grants and Contributions

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- If restricted to single program, reported with that program
- Multi-purpose grants should be divided amongst benefited programs
- Grants not restricted to a particular program must be reported as general revenues
- If earnings on investments are restricted to program use, then reported as program revenue (otherwise report as general revenue)

# Internal Service Funds

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- Must be reconciled out of existence before preparing government-wide financial statements.
- Assets, liabilities, and net assets allocated to activity most supported by ISF
  - Governmental Activities
  - Business-type Activities
- Allocation process identified in Chapter 14

# Infrastructure Capital Assets

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- Accounting and reporting first ***required*** by GASBS 34
- Governments were given extra time to capture infrastructure asset data
  - Allowed to use estimated costs
  - Only required to capitalize major infrastructure assets acquired since 1981
  - Small governments not required to capture existing infrastructure asset information
  - Governments may use modified approach for infrastructure in lieu of depreciation

# Note Disclosures

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- Often the section of Basic Financial Statements that takes up the most number of pages
- GASB has two lists of notes in *Codification* [Page 535]
  - Essential for fair presentation of the Basic Financial Statements
  - Additional note disclosures, if applicable
- Governments may present information beyond what is in these two lists, but shouldn't present unnecessary or redundant information

# Required Supplementary Information

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## Management's Discussion and Analysis (MD&A)

- New requirement under GASBS 34
- Presented after auditor's opinion but before financial statements (RSI traditionally placed after the notes to the financial statements)
- Standard provides 8 elements which must be presented in MD&A, if applicable – governments may **not** present other items [Page 537]
- Example included in Appendix 13-1



# Other RSI

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- Budgetary comparison schedules not included in Basic Financial Statements
- Certain 10-year historical trend data for defined benefit Public Employee Retirement Systems
- Certain presentations required for public entity risk pools
- Disclosures required by governments that use the modified approach in accounting & reporting for infrastructure

# Final Note on Minimum External Financial Report (MEFR)

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- Recall that MEFR includes:
  - MD&A
  - Basic Financial Statements
  - Other RSI
- When preparing report, government could exclude MD&A and Other RSI and still receive an unqualified opinion
- ***HOWEVER***, auditor must not absence of these elements in opinion

# Special Purpose Governments (SPGs)

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- Some – like school boards – may present same financial statements discussed here
- More restricted SPGs may have only one function – governmental activities or business-type activities
  - Would present only statements required for particular function
  - MD&A, notes, and other RSI would be limited as well