A Basic Background & Overview of State and Local Government Accounting

Part 1 of a 2-Part Series
A Governmental Audit Quality Center Web Event

February 6, 2018

Presenters

Corey Arvizu, CPA
HeinfeldMeech

Frank Crawford, CPA
Crawford & Associates
What We Will Cover

State and Local Government Reporting Principles
Financial Reporting Entity
Basic Financial Statements

Terminology & Abbreviations (for reference)

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<th>Description</th>
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<td>State and Local Government</td>
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Panel Discussion

What benefits have you experienced in your career by specializing in governmental accounting and auditing?

SLG Reporting Principles

History of the Governmental Accounting Standards Board
Objectives of SLG Financial Reporting
GAAP
History of the GASB

Financial Accounting Foundation (FAF)

Financial Accounting Standards Board (FASB)

Governmental Accounting Standards Board (GASB)

GASB GAAP

AICPA recognizes GASB as the standard-setting authority for GAAP for state and local governments.

Definition of a Government:

- GASB Codification 1000.801 & 1000 fn 4
- Factors that are *irrelevant* for determining appropriate GAAP
  - Incorporation as a not for profit organization
  - Exempt from federal income taxation (e.g., Internal Revenue Code section 501)
Objectives of Governmental Financial Reporting

1. Assist in fulfilling government's duty to be publicly accountable and should enable users to assess that accountability.

2. Assist users in evaluating the operating results of the governmental entity for the year.

3. Assist users in assessing the level of services that can be provided by the governmental entity and its ability to meet its obligations as they become due.

GASB GAAP

GAAP-based financial reports provide the public with the information necessary to assess the accountability of a government, primarily by:

• Assessing the financial condition and results of operations
• Comparing actual financial results with the legally-adopted budget, and
• Assisting in determining compliance with finance-related laws, rules, and regulations.
GAAP

**Recognition**—what items should be recognized in the financial statements (for example as assets, liabilities, revenues, and expenses)

**Measurement**—what amounts should be reported for each of the elements included in financial statements

**Presentation**—what line items, subtotals and totals should be displayed in the financial statements and how might items be aggregated within the financial statements

**Disclosure**—what specific information is most important to the users of the financial statements. Disclosures both supplement and explain amounts in the statements
Financial Reporting Entity

Primary Government Component Units (Discretely Presented & Blended)
Funds
Primary Government

Any state government or general-purpose local government

Special-purpose government that meets ALL of the following criteria:

- Separately elected governing body
- Legally separate
- Fiscally independent of other state and local governments

Primary government consists of all funds, organizations, institutions, agencies, departments, and offices that make up the legal entity.

Funds (Part of the Primary Government)

Fund Definition

- Fiscal and accounting entity
- Self-balancing set of accounts
- Resources segregated for specific activities or objectives
  - Special regulations
  - Restrictions
  - Limitations

Fund Application

- No limit to the number of funds (as long as meet criteria)
- Must always be justified based upon either the law or limitations on the use of resources
Component Units

Legally separate entity for which the PG is either:
- Financially accountable (fiscally dependent and financial benefit/burden)
- Omission may be potentially misleading based on nature and significance of relationship

Presentation of Component Units

Government-wide, full accrual statements (discussed later)
- Discretely presented (own column) OR
- Blended with the primary government (based on specific criteria)
Panel Discussion

You just discussed primary governments and component units which are unique to governments. Can you give us some examples of what the financial reporting entity of a city or a school district may include?

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives.
Governmental Funds

Activities normally associated with governments
Measurement focus – flow of current financial resources
Basis of accounting – modified accrual
Focus on budget

Types of governmental funds
- General fund
- Special revenue fund
- Debt service fund
- Capital project fund
- Permanent fund

General Fund

All financial resources not accounted for and reported in another fund (only 1 general fund)
Examples:
- Police department
- Fire department
- Administration/finance
- Streets/highway department
- Instruction (school district)
Special Revenue Funds

Proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects.

Examples:
- Grants
- Libraries
- Food services
- Human services
- Revolving loan funds

Capital Projects Funds

Financial resources that are restricted, committed, or assigned to expenditure for capital outlay, including the acquisition or construction of capital facilities and other capital assets.

Examples:
- New city hall building
- Convention center, fire station
- Major street projects
- Tax increment financing districts
- School improvements
Debt Service Funds

Financial resources that are restricted, committed, or assigned to expenditure for principal and interest

Examples:
- General obligation bonds
- Special assessment bonds

Permanent Funds

Resources that are restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs

Example:
- State endowment established with oil and gas revenues
Proprietary Funds

May operate similar to businesses
Objective – to recover costs through charges
Basis of accounting – full accrual

Types of Proprietary Funds:
• Enterprise funds
• Internal service funds

Enterprise Funds

Permitted or required for any activity for which a fee is charged to external users for goods or services
Examples:
• Water, electric and sewer utilities
• Storm water utilities
• Mass transit
• Hospitals
• Landfills
Internal Service Funds

Permitted for any activity that provides for goods and services on a cost-reimbursement basis to other funds, departments, or agencies of the PG and its component units, or to other governments.

Examples:
- Self-insurance
- Central printing/duplication services
- Central stores and motor pools

Fiduciary Funds

Resources held in a trust or custodial capacity.

Examples:
- Agency/Custodial funds
- Trust Funds
  - Pension
  - Private purpose
  - Investment

GASB 84, Fiduciary Activities
Panel Discussion

In your experience, do most governments have the same array of funds? Also, how many funds does a typical government have? Is there a limit?

Fund Presentation: Major/Non-Major Funds

**Major Funds (each in a separate column)**
- General Fund is *always* major
- Others required to be major:
  - 10% of Fund Types **AND** 5% of combined Governmental and Enterprise Fund Types
- Any fund that the management believes is important to users

**Nonmajor Funds**
- All other funds – single column presentation
Presenting LESS Than the Full Reporting Entity

Sometimes governments prepare separate financial statements for a:

- Fund
- Department
- Agency
- Program

GASB does not address separately issued GAAP-based financial statements for such entities. However, there is a long-established practice dictating those presentation should apply all relevant GAAP.

BFS

Fund Financial Statements
Government-Wide Financial Statements
Notes
RSI
Converting Fund-based Financial Statements to Government-Wide
Minimum Required Financial Presentation

BFS

- Government-wide financial statements
- Fund financial statements including reconciliations
- Notes to the financial statements
- RSI other than MD&A

BFS, Including Notes

- Government-wide financial statements
- Fund financial statements
  - Governmental fund types, proprietary fund types, and fiduciary fund types
  - Major funds vs non-major funds
- Note disclosures
Government-wide financial statements

- Governmental Activities
- Business-type Activities
- Discretely Presented Component Units

Except those fiduciary in nature

Fund Financial Statements

- Governmental Funds
  - Each Major Governmental Fund
  - Aggregate Nonmajor Governmental Funds
- Proprietary Funds
  - Each Major Enterprise Fund
  - Aggregate Nonmajor Enterprise Funds
- Fiduciary Funds
  - Internal Service Fund Type
  - Pension/OPEB Trust Fund
  - Investment Trust Fund
  - Private-Purpose Trust Fund
  - Agency/Custodial Funds
Panel Discussion

That seems like a large number of financial statements. What has been your experience in terms of the main users for each type of financial statement?

Basis of Accounting

**Cash basis**
- Transactions recorded when cash is exchanged
- Not GAAP

**Modified accrual**
- Revenues recognized when measurable and available; expenditures when incurred (with exceptions)
- Unique to state and local governments
- Current Financial Resources Measurement Focus

**Accrual**
- Records effects of transactions/events when they occur, regardless of the timing of related cash flows
- Used by business enterprises and non-profits
- Economic Resources Measurement Focus
### Governmental Fund Financial Statements: *Modified Accrual* vs. Proprietary Fund Financial Statements: *Accrual*

<table>
<thead>
<tr>
<th></th>
<th>Governmental Fund Financial Statements: Modified Accrual</th>
<th>Proprietary Fund Financial Statements: Accrual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues and other financial resources are recognized when they are</td>
<td></td>
<td>Revenues are recognized when they are both earned and measurable</td>
</tr>
<tr>
<td><strong>measureable and available</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenditures are recognized when a liability has been <strong>incurred</strong> with certain exceptions when normally expected to be liquidated with expendable available financial resources.</td>
<td></td>
<td>Expenses are recognized as they are <strong>incurred</strong></td>
</tr>
<tr>
<td>Current (short term) resources</td>
<td></td>
<td>Current and non-current resources</td>
</tr>
</tbody>
</table>

### Assets + Deferred Outflows = Liabilities + Deferred Inflows + Equity

**Deferred inflows:** acquisition of net position that applies to future periods (revenue recognized in future period)
- Unavailable (deferred) revenues
- Unamortized gains on long term debt
- Pension related amounts

**Deferred outflows:** consumption of net position that applies to a future period (expense not recognized until future period)
- Unamortized loss on bond refunding
- Pension related amounts
Governmental Fund Statements

Two basic financial statements:
1. Balance sheet
2. Statement of revenues, expenditures, and changes in fund balances

Include a summary reconciliation (net position & change in net position) of the governmental funds to the governmental activities (government-wide).

1. Balance Sheet

Only current financial assets – no capital assets

Exclude liabilities not normally expected to be liquidated with expendable available financial resources

Fund balance presentation

- Nonspendable
- Restricted
- Committed
- Assigned
- Unassigned
2. Statement of Revenues, Expenditures, and Changes in Fund Balances

Revenues by source

Expenditures by function and character
- Current
- Debt service
- Capital outlay

Other financing sources and uses
- Transfers from other funds
- Debt-related
Proprietary Fund Statements

Three basic financial statements:

1. Statement of net position (balance sheet)
2. Statement of revenues, expenses and changes in net position
3. Statement of cash flows
   - Direct method required

Include a summary reconciliation (net position & change in net position) of the enterprise funds to the business-type activities (government-wide).
1. Statement of Net Position

Reporting units

- Major enterprise funds
- Non-major enterprise funds in the aggregate
- Internal service fund type

Total column – enterprise funds

Classified presentation

- Restricted assets used to pay current liabilities reported in current category

Proprietary

1. Statement of Net Position (cont.)

All assets

- Financial
- Nonfinancial

All liabilities

Three classes of net position based on accessibility
2. Statement of Revenues, Expenses, and Changes in Net Position

Operating revenue and expense separate from non-operating items

Capital contributions and transfers separate
### Statement of Cash Flows

#### Four categories:

1. **Operating activities**
   - Does not include interest
2. **Non-capital financing activities**
3. **Capital and related financing activities**
4. **Investing activities**
   - Does not include capital acquisition

#### Financing activities (single category in private sector)
### Fiduciary Fund Statements

Two basic financial statements:

1. **Statement of net position**
   - One column for each fund type
   - Only one category of net position

2. **Statement of changes in net position**
   - Additions and deductions
   - Investment expenses reported as adjustment to additions rather than as a deduction

### Government-Wide Financial Statements

Two basic financial statements:

1. **Statement of net position**
2. **Statement of activities**
1. Statement of Net Position

Reporting units – governmental activities, business-type activities, component units

Governmental activities include non-financial assets (capital assets)

Governmental activities include outstanding long-term debt

Three categories of net position

- Net Investment in Capital Assets
- Restricted
- Unrestricted

Include also deferred inflows of resources and net position

EXAMPLE CITY
STATEMENT OF NET POSITION
JUNE 30, 2017

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Governmental Activities</th>
<th>Business-type Activities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$23,387,814</td>
<td>$23,383,276</td>
<td>$47,771,090</td>
</tr>
<tr>
<td>Restricted cash and investments</td>
<td>824,000</td>
<td>824,000</td>
<td></td>
</tr>
<tr>
<td>Taxes receivable</td>
<td>1,573,555</td>
<td>1,573,555</td>
<td></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>330,013</td>
<td>2,604,213</td>
<td>2,934,226</td>
</tr>
<tr>
<td>Intergovernmental receivable</td>
<td>2,122,002</td>
<td>2,122,002</td>
<td></td>
</tr>
<tr>
<td>Special assessments</td>
<td>645,000</td>
<td>645,000</td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>115,000</td>
<td>115,000</td>
<td></td>
</tr>
<tr>
<td>Prepaid items</td>
<td>185,474</td>
<td>2,975</td>
<td>188,449</td>
</tr>
<tr>
<td>Total current assets</td>
<td>29,378,923</td>
<td>26,950,464</td>
<td>56,329,387</td>
</tr>
<tr>
<td>Noncurrent assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital assets, non-depreciable</td>
<td>23,767,008</td>
<td>11,866,452</td>
<td>35,633,460</td>
</tr>
<tr>
<td>Capital assets, depreciable (net)</td>
<td>115,327,529</td>
<td>92,452,769</td>
<td>207,780,298</td>
</tr>
<tr>
<td>Total noncurrent assets</td>
<td>117,384,535</td>
<td>104,319,221</td>
<td>221,703,756</td>
</tr>
<tr>
<td>Total assets</td>
<td>147,663,458</td>
<td>131,272,685</td>
<td>278,936,143</td>
</tr>
</tbody>
</table>

DEBTOutflows OF RESOURCES

Deferred charge on refunding | 1,506,692 | 1,506,692 |
| Pension plan items | 11,293,094 | 2,570,024 | 13,863,118 |
| Total deferred outflows of resources | 11,293,094 | 2,570,024 | 13,863,118 |

LIABILITIES

| Current liabilities: |
| Accounts payable | 2,862,412 | 850,491 | 3,412,903 |

Component Unit Total, if any
2. Statement of Activities

Expenses before revenues

Detail of expenses
• By function
• Interest separate line within governmental activities

Net program cost format

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EXEMPLARY CITIES
STATEMENT OF ACTIVITIES
YEAR ENDED JUNE 30, 2017

<table>
<thead>
<tr>
<th>Functions/Programs</th>
<th>Expenses</th>
<th>Charges for Services</th>
<th>Operating Grants and Contributions</th>
<th>Capital Grants and Contributions</th>
<th>Governmental Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Government</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Governmental activities:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General government</td>
<td>12,130,905</td>
<td>4,901,504</td>
<td>182,854</td>
<td>210,909</td>
<td>(6,835,638)</td>
</tr>
<tr>
<td>Public safety</td>
<td>22,251,172</td>
<td>138,675</td>
<td>901,893</td>
<td>82,884</td>
<td>(21,068,937)</td>
</tr>
<tr>
<td>Highway and streets</td>
<td>9,417,409</td>
<td>1,052,167</td>
<td>2,083,359</td>
<td>6,455,009</td>
<td>173,707</td>
</tr>
<tr>
<td>Transit</td>
<td>1,533,258</td>
<td>100,052</td>
<td>1,418,740</td>
<td></td>
<td>(14,466)</td>
</tr>
<tr>
<td>Culture and recreation</td>
<td>10,204,276</td>
<td>4,611,576</td>
<td>17,323</td>
<td></td>
<td>(5,575,377)</td>
</tr>
<tr>
<td>Interest on long-term debt</td>
<td>$11,502</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total governmental activities</td>
<td>56,048,572</td>
<td>10,803,374</td>
<td>4,664,197</td>
<td>6,740,407</td>
<td>(33,831,594)</td>
</tr>
</tbody>
</table>

Business-type activities:

Water                                     | 14,753,418 | 18,158,385         |                                    | 1,097,285                       |                         |
Stormwater drainage                       | 1,135,494   | 1,314,787           |                                    |                                  |                         |
Total business-type activities            | 15,888,912 | 19,473,172          |                                    | 1,097,285                       |                         |
Total primary government                  | 77,222,111 | 57,630,246          | 4,664,197                         | 7,846,683                       | (33,831,594)            |

Cont’d
Clients usually do not keep books on this basis

Government-wide statements are for external financial reporting only

Conversion from modified accrual to full accrual needed

• Common conversion or eliminating entries:
  – Capitalize governmental fund capital assets
  – Record long-term debt and accrued interest
  – Net interfund balances and transfers (should = $0)
Panel Discussion

Is the conversion process to get to the government-wide financial statements typically easy for governments?

Note Disclosures

Summary of significant accounting policies
Stewardship, compliance and accountability
Detailed notes on all funds
Other information
RSI: MD&A

Prepared by the client

Narrative introduction, overview and analysis

Limited to topics specified by GAAP
  – Level of detail may be expanded

Include comparative data from government-wide statements

Placed before the financial statements

RSI Other than MD&A

Required by GAAP

Budgetary reporting
  • Required for general fund and major special revenue funds
  • Options for presentation: RSI or BFS

Other topics, depending on the nature of the government
  • Common examples include:
    – Pension & OPEB information (beyond what is reported in the f/s)
CAFR (Comprehensive Annual Financial Report)  

Financial reports containing additional reporting requirements.

Prepared to receive excellence awards from Association of School of Business Officials International and/or Government Finance Officers Association.

CAFRs contain:

- Transmittal letter
- MD&A
- BFS
- Budget to Actual Schedules
- Combining Statements & Schedules
- Statistical Section

Panel Discussion

What do you believe are the key takeaways relating to this area for those in the beginner category?
Now….What About Auditing??

Don’t forget about next week’s session titled, Part 2: A Basic Background & Overview of SLG Auditing

– February 13, 2018, from 1:00 PM – 3:00 PM (Eastern)

If you signed up for the bundle, you are all set

If you did not sign up for the bundle, but now want to register for Part 2:

– GAQC member registration for Part 2 (See GAQC Alert No. 353)
– Non-GAQC member registration for Part 2

Resources

GASB
AICPA
GASB Resources

GASB pronouncements available to download

Educational Resources
  • Webinars
  • Podcasts
  • Plain Language Articles

Technical Inquiries

AICPA Resources

AICPA Audit and Accounting Guide, *State and Local Governments*
  • www.aicpastore.com

GAQC Web site: www.aicpa.org/GAQC
  • GASB matters section
  • Archived GAQC web events
Thank you