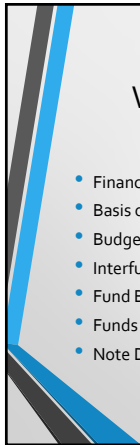


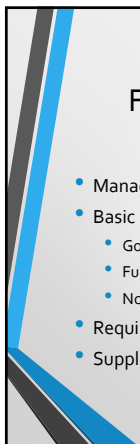
Understanding Financial Statements

Jeremy "Hank" Farrah, RKO



What We Will Be Discussing

- Financial Statement Format
- Basis of Accounting and Measurement Focus
- Budget to Actual Statements
- Interfund Balances
- Fund Balance
- Funds Other Than the General Fund
- Note Disclosures



Financial Statement Format

- Management's Discussion and Analysis (MD&A)
- Basic Financial Statements
 - Government-wide financial statements
 - Fund financial statements
 - Notes to basic financial statements
- Required Supplementary Information (RSI)
- Supplementary Information

Government-wide Financial Statements

- Statement of Net Position
- Statement of Activities
- Recorded on the accrual basis of accounting

Fund Financial Statements

- Balance Sheet – Governmental Funds
- Statement of Revenues, Expenditures, and Changes in Fund Balances
- Budget to Actual Statement (can also be RSI)
- Statement of Fiduciary Net Position
- Statement of Changes in Fiduciary Net Position
- Recorded on the modified accrual basis of accounting

What's a Major Fund?

- Total assets, liabilities, revenues, or expenditures of that individual fund are at least 10% of the corresponding total for all funds of that category or type
- General Fund is always considered major
- Major funds must be presented in separate columns in the basic financial statements

Required Supplementary Information

- Follows the notes to the basic financial statements
- Contains information about the net pension liability required to be recorded under GASB 68
- Budget to actual statements may also be presented as RSI

Supplementary Information

- Summary statements for non-major governmental funds
- Combining balance sheets
- Combining statements of revenues, expenditures, and changes in fund balances

GAAP Basis Accounting

- Generally Accepted Accounting Principles
- Defined as conventions, rules, and procedures necessary to describe accepted accounting practices at a particular time
- AICPA Council has designated the Governmental Accounting Standards Board (GASB) as the body to establish accounting principals for state and local governments

GAAP Basis Accounting

- Rule 203 of the AICPA's Code of Professional Conduct states that a member shall not:
 - 1) Express an opinion or state affirmatively that the financial statements are presented in conformity with GAAP or 2) State that they are not aware of any material modifications that should be made to such statements in order for them to be in conformity with GAAP if such statements contain any departures from an accounting principal promulgated by bodies designated by Council to establish such standards

Basis of Accounting

- Determines when transactions and economic events are reflected in the financial statements
- When revenues, expenditures, expenses, and transfers – and the related assets and liabilities – are recognized in the accounts and reported in the financial statements
- Two types we will be discussing:
 - Accrual Basis (Entity-wide financial statements)
 - Modified Accrual Basis (Fund financial statements)

Accrual Basis of Accounting

- Records the financial effects of transactions that have cash consequences in the periods in which those transactions occur rather than only in the periods in which cash is received or paid
- Essential elements:
 - Accrual of revenues that have been earned
 - Accrual of expenses that have been incurred
 - Capitalization of expenditures and depreciation
 - Deferral of expenditures and amortization
 - Deferral of revenues until they are earned

Modified Accrual Basis of Accounting

- Variation of accrual that modifies the basis for certain cash flow considerations
- Revenues should be recorded when they are "susceptible to accrual"
- Revenue must be both measurable and available to finance current expenditures
- Revenue is considered available when it is collectible during the current period and actual collection will occur either during the current period or soon enough after the end of the period to be used to pay current year end liabilities

Modified Accrual Basis of Accounting

- Expenditures are recorded when they are normally expected to be liquidated with current financial resources
- Expenditures differ from expenses in that they represent a "decrease in net financial resources"
- Most expenditures are recorded when a liability is incurred, the current financial resources measurement focus of a governmental fund significantly affects what items are considered expenditures

Measurement Focus

- Identifies what and how transactions and events should be recorded
- Concerned with the inflow and outflow of resources
- Two types we will be discussing:
 - Flow of Economic Resources (Accrual)
 - Flow of Current Financial Resources (Modified Accrual)

Flow of Economic Resources

- Refers to the reporting of all of the net position available to the governmental unit for the purpose of providing goods and services to the public
- Includes all costs of providing goods and services during the period
- All assets, deferred outflows, liabilities, and deferred inflows are presented in the balance sheet or statement of net position

Flow of Current Financial Resources

- Assets include only those considered current financial resources
- Liabilities include only those expected to be liquidated with current financial resources
- Revenues are accrued only if the revenues are earned and are expected to be collected in time to pay for liabilities in existence at the end of period
- Expenditures are accrued when they are normally expected to be paid out of revenues recognized during the current period

Budgetary Accounting

- A budget is a plan of financial operations that provides a basis for planning, controlling, and evaluating governmental activities
- Should be used by certain governmental fund types, mainly the General Fund and Special Revenue Funds
- Governmental funds generally use a legally adopted fixed budget, which reflects a specific estimate for revenues and appropriations for expenditures

Budgetary Accounting

- Many governments adopt a budget on a basis of accounting other than GAAP
 - Cash basis
 - Modified cash basis
 - Regulatory basis
- When budgetary and GAAP basis of accounting are different, a government unit usually maintains its records on the budgetary basis

GAAP vs. Budgetary Accounting

- Most common differences:
 - Accrual for teacher summer salaries
 - Encumbrances
 - On-behalf payments
 - Changes in assigned/committed funds which are now reported in the General Fund due to GASB 54 (Fund Balance Reporting and Governmental Fund Type Definitions)

Accrual for Teacher Summer Salaries

- Salaries, wages, and benefits earned prior to June 30, but paid out in July and August
- Must be recorded on a GAAP basis
- If entity ceased to exist as of June 30, the entity would still be responsible for paying this accrual

Encumbrances

- Represent commitments related to contracts not yet performed and orders not yet filled (open purchase orders), and they are used to control expenditure commitments for the year
- Encumbrances outstanding at year end are not expenditures for the year, and the reserve for encumbrances is not a liability
- Encumbrances can lapse at year end or be carried forward to the next fiscal year

On-Behalf Payments

- Direct payments made by one entity to a third party recipient for the employees of another, legally separate entity
- Contributions made by the State of Maine to the Maine Public Employees Retirement System for non-federally-funded teachers
- Recorded as a revenue and expenditure in the GAAP basis fund financial statements and the entity-wide financial statements
- No effect on fund balance or net position

Assigned/Committed Funds

- Some funds which were reported as special revenue funds prior to GASB 54 now do not meet the definition of a special revenue fund and must be reported in the general fund
- Changes in these funds are recorded in the GAAP basis fund financial statements and do not effect the budget to actual statement for the general fund

Budget to Actual Statements

- Budgetary comparison schedules are required for the general fund and each major special revenue fund (with a legally adopted budget)
- Presented as a basic financial statement or required supplementary information (RSI)
- Schedule should include:
 - Original budget
 - Final appropriated budget
 - Actual results (presented on budgetary basis)
 - Differences between final budget and actual results (encouraged, but not required)

Budget to Actual Statements

- Any excess of expenditures over appropriations must be disclosed in the notes to the financial statements (or notes to RSI)
- Must include a reconciliation between the budgetary information and the GAAP information

Interfund Receivables and Payables

- Also known as "due to" and "due from" accounts (DTF)
- Interfunds are generated when utilizing a central checking account, usually held in the General Fund, to handle revenues and expenditures of all other funds
- The interfund balance represents how much cash that fund would have if each individual fund had its own checking account

Fund Balance

- Five categories:
 - Nonspendable
 - Restricted
 - Committed
 - Assigned
 - Unassigned

Nonspendable

- Funds that can't be spent
 - Not in spendable form
 - Inventory, prepaids
 - Long-term loans and notes receivable
 - Property for resale
 - Legally or contractually required to be intact
 - Principal amount of permanent funds

Restricted

- Constraints placed on use of proceeds
- Externally imposed by creditors, grantors, laws or regulations of other governments
- Imposed by law through constitutional provisions or enabling legislation

Committed

- Used for specific purposes
- Imposed by formal action of government's highest level of decision making authority
- Cannot be used for any other purpose unless the government removes or changes the specified use
- Incorporate contractual obligations

Assigned

- Constrained by government's intent
- Intent is expressed by
 - Governing body itself
 - A body or official that governing body has delegated authority to assign amounts

Unassigned

- Residual classification for general fund
- General fund should be only fund with positive unassigned fund balance
- Negative fund balances of funds other than the General Fund
- Title 20-A states unallocated balances in excess of 3% must be used to reduce State and local share of the total allocation and must be disbursed within 3 years

Budgetary vs. GAAP – Fund Balance

- GAAP basis takes teacher summer salaries and benefits into account when calculating ending fund balance
- Budgetary (cash) basis adds back the accrual for the summer salaries and benefits to the ending fund balance amount to come up with a budgetary fund balance figure
- Best practices is to budget for teacher summer salaries on a GAAP basis

Budgeted Use of Fund Balance

- You should not budget to use fund balance if you do not have any fund balance to use!
- If your budget is perfect, all actual revenues and expenditures match what you budgeted, your fund balance would decrease by the amount of fund balance that was budgeted to use

Funds Other than the General Fund

- Special Revenue Funds
- Capital Project Funds
- Permanent Funds
- Fiduciary Funds:
 - Private-Purpose Trust Funds
 - Agency Funds

Special Revenue Funds

- Proceeds of specific revenue resources that are restricted or committed for specified purposes
- Discontinue fund if no longer expecting a substantial portion of inflows will derive from restricted or committed revenue sources
- Examples:
 - Title IA, Local Entitlement, Title IIA
 - School Lunch (in most cases)

Capital Project Funds

- Resources restricted, committed, or assigned to expenditure for capital outlays
- Includes construction of facilities and other capital assets
- Examples:
 - Construction of new school
 - Funds set aside for purchase of school buses

Permanent Funds

- Resources that are restricted to the extent that only earnings and not principal may be used for purposes that support government programs
- Example:
 - Endowment for the maintenance of athletic fields, where the original donation must be kept intact and only investment income may be used for expenditures

Private-Purpose Trust Funds

- Accounts for the principal and income for trust arrangements that benefit individuals, private organizations, or other governments
- Example:
 - Scholarship funds for students

Agency Funds

- Assets held by the governmental entity for other parties that cannot be used to finance the governmental entity's own operating programs
- Example:
 - Student activity funds

Fund Deficits

- Must be reported as unassigned fund balance
- Must be disclosed in the notes to the financial statements
- Be aware of fund deficits in:
 - School Lunch Funds
 - Grant Funds
 - Capital Projects
- The General Fund may have to cover the overages in funds if future revenues are not sufficient to cover those overages

Inactive Funds

- Funds with no activity for multiple fiscal years
- Should be closed by either:
 - Transfers in or out from another fund (usually General Fund)
 - Spending the funds appropriately

Note Disclosures

- Summary of Significant Accounting Policies
- Long-Term Debt
 - Bonds and capital leases payable
 - Debt to maturity schedules
- Net Pension Liability
- Capital Assets
