

The Quick Guide to Local Government Financial Statements



Dean Michael Mead

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WHAT IS THE PURPOSE OF GOVERNMENT FINANCIAL STATEMENTS?

- Most local government services are unlike businesses—cities and counties do not charge citizens directly for most services they receive, but rather finance services with taxes and other fees applied generally to the public.
- Because it is not always clear how the taxes and fees citizens pay relate to the services they receive in return, and because citizens have little choice about paying them, local governments must take special care to demonstrate that they have been accountable to the public.
- Financial statements are an important way for counties, cities, towns, villages, and other local governments to demonstrate their accountability.

FINANCIAL STATEMENTS PROVIDE INFORMATION ABOUT THE WHOLE GOVERNMENT

- The first two financial statements in a local government's annual financial report are the GOVERNMENT-WIDE FINANCIAL STATEMENTS—the STATEMENT OF NET ASSETS (Figure 1) and the STATEMENT OF ACTIVITIES (Figure 2). They provide comprehensive information about the entire government, including all of its:
 - GOVERNMENTAL ACTIVITIES—the traditional activities of local government, such as parks and recreation, police, and fire; they are financed by taxes and other revenues levied generally on the public; in the absence of government provision, many of these services might not occur in the private sector.
 - BUSINESS-TYPE ACTIVITIES—services that charge a fee directly to the users of the service generally in order to cover their costs of operation; examples might include water and sewer systems and municipal golf courses.
 - COMPONENT UNITS—governmental organizations that are legally distinct from the government that created them, but for which the elected officials of the government are nonetheless financially accountable; examples might include housing authorities and school districts.

Figure 1. Illustrative Government-wide Statement of Net Assets

Governments provide a note that includes the beginning and ending balances of major classes of capital assets and their related accumulated depreciation, and that shows how they changed from the previous year.

The statement of net assets reports what the government owns and owes at a given point in time, usually the end of the fiscal year.

Local City
Statement of Net Assets
As of December 31, 2002

Assets are presented in order of how readily they can be converted to cash; cash is the most liquid, capital assets least.

Most capital assets are shown at their original purchase/construction cost, less annual depreciation charges accumulated over time, except for land and infrastructure reported with the "modified approach," which are not depreciated. Local's roads and highways are not depreciated.

	Primary Government		Total	Component	
	Governmental Activities	Business-type Activities		Units	Units
Cash and cash equivalents	\$ 13,597,899	\$ 8,785,821	\$ 22,383,720	\$	303,935
Investments	27,365,221	—	27,365,221		7,428,952
Receivables (net)	12,833,132	3,609,615	16,442,747		4,042,290
Internal balances	175,000	(175,000)	—		—
Inventories	322,149	126,674	448,823		83,697
Total current assets	54,293,401	12,347,110	66,640,511		11,858,874
Noncurrent assets:					
Restricted cash and cash equivalents	—	1,493,322	1,493,322		—
Capital assets:					
Land and nondepreciable infrastructure	88,253,120	3,836,119	92,089,239		—
Depreciable infrastructure, net	30,367,241	30,952,214	61,319,455		751,239
Depreciable buildings, property, and equipment, net	51,402,399	116,600,418	168,002,817		36,993,547
Total noncurrent assets	170,022,760	152,882,073	322,904,833		37,744,786
Total assets	224,316,161	165,229,183	389,545,344		49,603,660

LIABILITIES

Current liabilities:

Accounts payable

Deferred revenue

Current portion of long-term obligations

Total current liabilities

Noncurrent liabilities:

Noncurrent portion of long-term obligations

Total liabilities

NET ASSETS

Invested in capital assets, net of related debt

Restricted for:

Capital projects

Debt service

Community development projects

Other purposes

Unrestricted (deficit)

Total net assets

Governmental activities have no available unrestricted net assets because they owe more than they own. This fact is discernible because governments separate governmental from business-type activities in this statement.

Liabilities are shown in order of maturity or when cash is expected to be used to pay them.

Deferred revenue represents resources received that have not yet met the criteria for being recorded as revenues.

Governments provide a note that includes the beginning and ending balances of major types of long-term liabilities, and that shows how they changed from the previous year.

6,783,310	751,430	7,534,740	1,803,332
1,435,599	—	1,435,599	38,911
9,236,000	4,426,286	13,662,286	1,426,639
17,454,909	5,177,716	22,632,625	3,268,882
83,302,378	74,482,273	157,784,651	27,106,151
100,757,287	79,659,989	180,417,276	30,375,033
103,711,386	73,088,574	176,799,960	15,906,392
11,705,864	—	11,705,864	492,445
3,020,708	1,451,996	4,472,704	—
4,811,043	—	4,811,043	—
3,214,302	—	3,214,302	—
(2,904,429)	11,028,624	8,124,195	2,829,790
\$ 123,558,874	\$ 85,569,194	\$ 209,128,068	\$ 19,228,627

Total assets - total liabilities = total net assets
\$224,316,161 - \$100,757,287 = \$123,558,874

One way to judge a local government's ability to continue financing services in the future is to compare the primary government's cash and other current assets (in this case, everything but capital assets) with its current liabilities. \$66,640,511 ÷ \$22,632,625 = 2.94. In other words, this locality has liquid assets equal to nearly three times the liabilities expected to come

Figure 2. Illustrative Government-wide Statement of Activities

Local City
Statement of Activities
For the Year Ending December 31, 2002

Governments are not required to allocate overhead, interest, and other indirect expenses to the direct service functions. If they do, they must show how the expenses were allocated in a separate column here.

Functions/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary government:				
Governmental activities:				
General government	\$ 9,571,410	\$ 3,146,915	\$ 843,617	—
Public safety	34,844,749	1,198,855	1,307,693	\$ 62,300
Public works	10,128,538	850,000	—	2,252,615
Engineering services	1,299,645	704,793	—	—
Health and sanitation	6,738,672	5,612,267	575,000	—
Cemetery	735,866	212,496	—	—
Culture and recreation	11,532,350	3,995,199	2,450,000	—
Community development	2,994,389	—	—	2,580,000
Education (payment to school district)	21,893,273	—	—	—
Interest on long-term debt	6,068,121	—	—	—
Total governmental activities	105,807,013	15,720,525	5,176,310	4,894,915
Business-type activities:				
Water	3,595,733	4,159,350	—	1,159,909
Sewer	4,912,853	7,170,533	—	486,010
Parking facilities	2,796,283	1,344,087	—	—
Total business-type activities	11,304,869	12,673,970	—	1,645,919
Total primary government	\$ 117,111,882	\$ 28,394,495	\$ 5,176,310	\$ 6,540,834
Component units:				
Landfill	\$ 3,382,157	\$ 3,857,858	\$ —	\$ 11,397
Public school system	31,186,498	705,765	3,937,083	—
Total component units	\$ 34,568,655	\$ 4,563,623	\$ 3,937,083	\$ 11,397

At a minimum, governments report expenses at the same level of detail they do in the governmental fund statements. However, they are encouraged in the accounting rules to provide additional detail, such as police, fire, and ambulance service, instead of the broad public safety function.

A number of items affecting net assets are shown separately from general revenues, allowing you to determine if common annual revenues were sufficient to cover net expenses, and if unusual costs or resources affected the bottom line. In addition to transfers, special and extraordinary items are shown separately. **EXTRAORDINARY ITEMS** are revenues or expenses that are both unusual in nature and infrequent in occurrence; the costs of cleaning up after a tornado in a New England state would fit both criteria. **SPECIAL ITEMS** are one or the other, and are within the control of government—for example, proceeds from the sale of capital assets. Other changes in net assets shown separately from general revenues include contributions to term and permanent endowments and contributions to permanent fund principal.

- General revenues:
- Taxes:
 - Property taxes, levied for general purposes
 - Property taxes, levied for debt service
 - Franchise taxes
 - Public service taxes
 - Payment from Sample City
 - Grants and contributions not restricted to specific programs
 - Investment earnings
 - Miscellaneous
 - Special item—gain on sale of park land
 - Transfers
 - Total general revenues, special items, and transfers
 - Change in net assets
 - Net assets—beginning
 - Net assets—ending

An example of how this statement works. The total cost of the city's culture and recreation activities was \$11,532,350. Local City raised \$3,995,199 from admissions, permits, and other charges, and received another \$2,450,000 of operating grants and contributions, most in the form of state and federal aid. When these three types of program revenues are subtracted from total expenses for culture and recreation, a net expense of (\$5,087,151) is left. This is the portion of culture and recreation services costs that is borne generally by the public, rather than financed by revenues generated by the services themselves. The net amounts are totaled below (\$80,015,263), and the lower half of the statement shows the taxes and other general revenues the city used to finance it.

**Net (Expense) Revenue and
Changes in Net Assets**

Primary Government		Total	Component Units
Governmental Activities	Business-type Activities		
\$ (5,580,878)	—	\$ (5,580,878)	—
(32,275,901)	—	(32,275,901)	—
(7,025,923)	—	(7,025,923)	—
(594,852)	—	(594,852)	—
(551,405)	—	(551,405)	—
(523,370)	—	(523,370)	—
(5,087,151)	—	(5,087,151)	—
(414,389)	—	(414,389)	—
(21,893,273)	—	(21,893,273)	—
(6,068,121)	—	(6,068,121)	—
<u>(80,015,263)</u>	<u>—</u>	<u>(80,015,263)</u>	<u>—</u>
—	\$ 1,723,526	1,723,526	—
—	2,743,690	2,743,690	—
—	(1,452,196)	(1,452,196)	—
— #	3,015,020	3,015,020	—
<u>(80,015,263)</u>	<u>3,015,020</u>	<u>(77,000,243)</u>	<u>—</u>
—	—	—	\$ 487,098
—	—	—	(26,543,650)
—	—	—	<u>(26,056,552)</u>
51,693,573	—	51,693,573	—
4,726,244	—	4,726,244	—
4,055,505	—	4,055,505	—
8,969,887	—	8,969,887	—
—	—	—	21,893,273
1,457,820	—	1,457,820	6,461,708
1,958,144	601,349	2,559,493	881,763
884,907	104,925	989,832	22,464
2,653,488	—	2,653,488	—
501,409	(501,409)	—	—
<u>76,900,977</u>	<u>204,865</u>	<u>77,105,842</u>	<u>29,259,208</u>
(3,114,286) #	3,219,885	105,599	3,202,656
126,673,160	82,349,309	209,022,469	16,025,971
<u>\$ 123,558,874</u>	<u>\$ 85,569,194</u>	<u>\$ 209,128,068</u>	<u>\$ 19,228,627</u>

The last four columns are obtained by subtracting program revenues from expenses. (See the example at the bottom of the opposite page.) A (negative) figure represents a net expense to the government: the portion of expenses not covered by program revenues, but instead financed with taxes and other general revenues. Governmental activities typically have a net expense.

A positive figure is a net revenue: program revenues exceed program expenses, and make a net contribution to general revenues.

The change in net assets tells you whether a government's financial standing improved or declined in the last year. The net assets of governmental activities decreased (\$3,114,286), while those of the business-type activities increased \$3,219,885; in other words, the city's overall financial status improved very modestly (an increase of just \$105,599).

Statement of Net Assets

- The statement of net assets contains information about:
 - Things of value a local government owns or controls—its **ASSETS**
 - Amounts a local government owes—its **LIABILITIES**
 - What is left after assets are used to satisfy liabilities—its **NET ASSETS**.
- You can use the information in the statement of net assets to:
 - Identify what kinds of assets a local government owns, what kinds of debts it owes, and the nature of the net assets that remain
 - Learn about a local government’s long-lived capital assets, including **INFRASTRUCTURE** assets such as bridges and roads; governments that employ a “modified approach” to reporting infrastructure will provide information about the physical condition of these assets and their efforts to maintain them
 - Assess a local government’s ability to cover its costs and to continue financing services in the future; for instance, by comparing total assets with total liabilities
 - Find out how much of a local government’s net assets can be used to provide new services or start new programs, versus how much is invested in capital assets or restricted to specific purposes.

Statement of Activities

- The statement of activities contains information about:
 - The costs of providing public services—**EXPENSES**
 - The resources obtained to finance services—**REVENUES**.
- You can use the information in the statement of activities to:
 - Learn where a local government gets resources from and what it uses them for
 - Find out how much it costs a local government to provide its various services and programs
 - Determine the extent to which services cover their own costs with user fees, charges, and grants, as opposed to being financed with taxes, other general revenues, and resources accumulated from past years (See the “net (expense) revenue” columns in Figure 2.)
 - Identify out-of-the-ordinary costs and unusual sources of funding
 - Discover if sufficient resources were raised during the year to cover costs, or if there was a shortfall—for example, by subtracting total expenses from the sum of program and general revenues, for governmental or business-type activities
 - Determine if a local government’s fiscal status is improving or declining, by examining the “change in net assets” line at the bottom of the statement; a positive number is an improvement and a negative number is a decline.

FINANCIAL STATEMENTS PROVIDE DETAILED INFORMATION ABOUT A GOVERNMENT'S FUNDS

- Whereas the government-wide financial statements provide an all-encompassing view of a local government's finances, the remainder of the statements—collectively called **FUND FINANCIAL STATEMENTS**—provide a more detailed look at the major individual portions, or **FUNDS**, of a government.
 - There are three kinds of fund financial statements—governmental, proprietary, and fiduciary funds.

Governmental Funds

- The **GOVERNMENTAL FUNDS** report the finances of a local government's most basic services—generally the same as the governmental activities in the government-wide statements.
- The governmental funds report a narrower set of financial information than the government-wide and other funds statements:
 - The governmental funds statements generally include only *short-term information*—the most readily available assets and presently due liabilities, and just the resources that flow into and out of a local government during the year or shortly thereafter.
 - All of the other statements include *both short- and long-run* information—*all* assets, liabilities, revenues, and expenses.
- There are five kinds of governmental funds:
 - **GENERAL FUND**—typically the government's main operating fund; it accounts for resources not required to be in another fund.
 - **SPECIAL REVENUE FUNDS** track revenue sources legally restricted to specific uses. For example, state aid for mental health care might be tracked in a city's mental health fund.
 - **CAPITAL PROJECTS FUNDS** follow the resources used to build, acquire, and renovate major general capital assets. For example, a highway renovation fund might account for the use of proceeds from long-term bonds to rebuild a county's major roads.
 - **DEBT SERVICE FUNDS** account for resources used to repay general long-term debt.
 - **PERMANENT FUNDS** report resources legally restricted so that only the earnings they generate, and not the resources themselves, may be used. For instance, a village art endowment fund might track investments donated by a patron who stipulated that only the earnings may be used to purchase outdoor sculptures for public parks.

- The governmental funds financial statements show the MAJOR (most significant) FUNDS individually, and total the remaining governmental funds in a single column.
 - The general fund or its equivalent is always considered a major fund and is shown individually.
 - Other funds qualify as major based on the size of their assets, liabilities, revenues, or expenditures relative to other funds.
 - Finally, a local government may label any other fund as major and show it individually, even if it does not qualify by size, if the government believes that fund is important to the users of its financial statements.
- The governmental funds financial statements—the BALANCE SHEET (Figure 3) and the STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES (Figure 4)—include information you can use to:
 - Determine a local government’s short-term financing needs and assess its capacity to meet them—for instance, by comparing cash and short-term investments with liabilities that are expected to be liquidated in the next year
 - Assess a local government’s short-run ability to balance inflows of resources with outflows to pay for services by contrasting revenues and expenditures.

Proprietary Funds

- The PROPRIETARY FUNDS report the finances of activities a local government operates like a business.
- There are two kinds of proprietary funds:
 - ENTERPRISE FUNDS typically report the same kinds of services included in the business-type activities in the government-wide statements—for example, golf courses and utilities.
 - INTERNAL SERVICE FUNDS account for services that are provided to a local government’s own departments or agencies, such as a motor pool or central supply purchasing. They are usually included with the governmental activities in the government-wide statements.
- The three proprietary funds financial statements are the:
 - STATEMENT OF NET ASSETS
 - STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
 - STATEMENT OF CASH FLOWS—The purpose of this statement is to identify where cash comes from and how it is used—it shows whether a proprietary activity raised enough cash to pay its bills. The statement categorizes sources and uses of cash in four ways:
 - Operating cash flows—related to the provision of services and the production and sale of goods

- Noncapital financing cash flows—related to grants received from or provided to other governments, as well as transfers and borrowing money for purposes other than buying or building capital assets
- Capital and related financing cash flows—related to the receipt and use of cash for purchasing or constructing capital assets, such as from long-term borrowing or intergovernmental grants
- Investing cash flows—predominantly related to the sale and purchase of and earnings from investments.

Fiduciary Funds

- The FIDUCIARY FUNDS account for resources a local government manages or holds on behalf of others, such as employee pensions.
- There are four kinds of fiduciary funds:
 - PENSION (AND OTHER EMPLOYEE BENEFIT) TRUST FUNDS account for resources held in trust for the members and beneficiaries of various employee benefit plans, such as a retiree health insurance program.
 - INVESTMENT TRUST FUNDS track the portion of a local government's investment pools that belongs to other governments. For instance, a county may manage a short-term investment pool so localities can earn income from spare cash until it is needed.
 - PRIVATE-PURPOSE TRUST FUNDS report all other trust arrangements—for example, an unclaimed funds account that holds abandoned bank accounts and other property.
 - AGENCY FUNDS contain resources held on a temporary, purely custodial basis. For example, as a county collects its own property taxes, it may also collect for its villages and towns and then pass the money along.
- The fiduciary funds financial statements are the:
 - STATEMENT OF FIDUCIARY NET ASSETS
 - STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS.

Component Units

- The information in the COMPONENT UNITS FINANCIAL STATEMENTS can be used to examine the legally separate entities for which the elected officials of a local government are financially accountable.
- In addition to reporting them in the government-wide financial statements, local governments will provide additional information about the component units in one of two ways:
 - COMBINING FINANCIAL STATEMENTS of major component units between the fund financial statements and the notes, or
 - CONDENSED FINANCIAL STATEMENTS in the notes to the financial statements.

Figure 3. Illustrative Governmental Funds Balance Sheet, Local Government

The balance sheet serves a purpose similar to the statement of net assets, reporting what is owned (or controlled) and owed.

The governmental funds statements present a government's "major" funds. The funds that are not major are aggregated in a single column ("other governmental funds"); some governments report them individually in a combining statement with their supplemental information.

Local City
Balance Sheet
Governmental Funds
As of December 31, 2002

	HUD Programs		Community Redevelopment	Route 7 Construction	Other		Total
	General	Programs			Governmental Funds	Governmental Funds	
ASSETS							
Cash and cash equivalents	\$ 3,418,485	\$ 1,236,523	\$ —	\$ —	\$ 5,606,792	\$ —	\$ 10,261,800
Investments	—	—	13,262,695	10,467,037	3,485,252	—	27,214,984
Receivables, net	3,644,561	2,953,438	353,340	11,000	10,221	—	6,972,560
Due from other funds	1,370,757	—	—	—	—	—	1,370,757
Receivables from other governments	—	119,059	—	—	1,596,038	—	1,715,097
Liens receivable	791,926	3,195,745	—	—	—	—	3,987,671
Inventories	182,821	—	—	—	—	—	182,821
Total assets	\$ 9,408,550	\$ 7,504,765	\$ 13,616,035	\$ 10,478,037	\$ 10,698,303	\$ —	\$ 51,705,690

LIABILITIES AND FUND BALANCES

Liabilities:									
Accounts payable	\$ 3,408,680	\$ 129,975	\$ 190,548	\$ 1,104,632	\$ 1,074,831	\$ 5,908,666			
Due to other funds	—	25,369	—	—	—	25,369			
Payable to other governments	94,074	—	—	—	—	94,074			
Deferred revenue	4,250,430	6,273,045	250,000	11,000	—	10,784,475			
Total liabilities	7,753,184	6,428,389	440,548	1,115,632	1,074,831	16,812,584			

Fund balances:

Reserved for:									
Inventories	182,821	—	—	—	—	182,821			
Liens receivable	791,926	—	—	—	—	791,926			
Encumbrances	40,292	41,034	119,314	5,792,587	1,814,122	7,807,349			
Debt service	—	—	—	—	3,832,062	3,832,062			
Other purposes	—	—	—	—	1,405,300	1,405,300			
Unreserved, reported in:						0			
General fund	640,327	—	—	—	—	640,327			
Special revenue funds	—	1,035,342	—	—	1,330,718	2,366,060			
Capital projects funds	—	—	13,056,173	3,569,818	1,241,270	17,867,261			
Total fund balances	1,655,366	1,076,376	13,175,487	9,362,405	9,623,472	34,893,106			
Total liabilities and fund balances	\$ 9,408,550	\$ 7,504,765	\$ 13,616,035	\$ 10,478,037	\$ 10,698,303				

Governments reconcile or explain the reasons that total fund balances in this statement differ from total net assets for governmental activities in the government-wide statement of net assets. Many of the explanations relate to the fact that the governmental funds primarily report short-term financial information, whereas the government-wide statements report both short- and long-term information.

The reconciliation that you find may not be this detailed. Some governments provide greater detail in the notes to the financial statements if the descriptions here are broad or if there are important adjustments that cannot be identified within the larger categories. Some governments may place the reconciliation on a separate page from the statement. (See Figure 5, for example.)

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.

Other long-term assets are not available to pay for current-period expenditures and therefore are deferred in the funds.

Internal service funds are used by management to

charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets.

Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds.

161,082,708

9,348,876

2,994,691

(84,760,507)
\$ 123,568,874

Net assets of governmental activities

Figure 4. Illustrative Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances

This statement compares the flows of short-term resources into and out of a government. This statement and the statement of activities contain information for a period of time, usually a fiscal year; by contrast, the balance sheet and net assets statement contain data as of a single point in time, usually the end of a fiscal year.

	Local City					Total
	General	HUD Programs	Community Redevelopment	Route 7 Construction	Other Governmental Funds	
REVENUES						
Property taxes	\$ 51,173,436	\$ --	\$ --	\$ --	\$ 4,680,192	\$ 55,853,628
Franchise taxes	4,055,505	--	--	--	--	4,055,505
Public service taxes	8,969,887	--	--	--	--	8,969,887
Fees and fines	606,946	--	--	--	--	606,946
Licenses and permits	2,287,794	--	--	--	--	2,287,794
Intergovernmental	6,119,938	2,578,191	--	--	2,830,916	11,529,045
Charges for services	11,374,460	--	--	--	30,708	11,405,168
Investment earnings	552,325	87,106	549,489	270,161	364,330	1,823,411
Miscellaneous	881,874	66,176	--	2,939	94	951,083
Total revenues	86,022,165	2,731,473	549,489	273,100	7,906,240	97,482,467

	Local City					Total
	General	HUD Programs	Community Redevelopment	Route 7 Construction	Other Governmental Funds	
EXPENDITURES						
Current:						
General government	8,630,835	--	417,814	16,700	121,052	9,186,401
Public safety	33,729,623	--	--	--	--	33,729,623
Public works	4,975,775	--	--	--	3,721,542	8,697,317
Engineering services	1,299,645	--	--	--	--	1,299,645
Health and sanitation	6,070,032	--	--	--	--	6,070,032
Cemetery	706,305	--	--	--	--	706,305
Culture and recreation	11,411,685	--	--	--	--	11,411,685
Community development	--	2,954,389	--	--	--	2,954,389
Education--payment to school district	21,893,273	--	--	--	--	21,893,273
Debt service:						
Principal	--	--	--	--	3,450,000	3,450,000
Interest and other charges	--	--	--	--	5,215,151	5,215,151
Capital outlay	--	--	2,246,671	11,281,769	3,190,209	16,718,649
Total expenditures	88,717,173	2,954,389	2,664,485	11,298,469	15,697,954	121,332,470
Excess (deficiency) of revenues over expenditures	(2,695,008)	(222,916)	(2,114,996)	(11,025,369)	(7,791,714)	(23,850,003)

OTHER FINANCING SOURCES (USES)					
Proceeds of refunding bonds	—	—	—	38,045,000	38,045,000
Proceeds of long-term capital-related debt	—	17,529,560	—	1,300,000	18,829,560
Payment to bond refunding escrow agent	—	—	—	(37,284,144)	(37,284,144)
Transfers in	129,323	—	—	5,551,187	5,680,510
Transfers out	(2,163,759)	(348,046)	(2,273,187)	(219,076)	(5,094,068)
Total other financing sources and uses	(2,034,436)	(348,046)	15,256,373	7,992,967	20,266,858
SPECIAL ITEM					
Proceeds from sale of park land	3,476,488	—	—	—	3,476,488
Total other financing sources (uses) and special items	1,442,052	(348,046)	15,256,373	7,456,376	23,806,755
Net change in fund balances	(1,252,956)	(570,962)	13,141,377	(398,747)	(106,657)
Fund balances—beginning	2,908,322	1,647,338	34,110	10,022,219	34,999,763
Fund balances—ending	\$ 1,655,366	\$ 1,076,376	\$ 13,175,487	\$ 9,623,472	\$ 34,893,106

Capital outlays are amounts disbursed for the purchase, construction, and rehabilitation of capital assets. In the government-wide statements these amounts usually are not expensed immediately. Rather, they are added to the capital assets accounts and the expense is spread over the useful lives of the assets in the form of annual depreciation expenses.

Every governmental fund had a deficit—expenditures were greater than revenues. The deficits in the two capital projects funds, however, arise in part because their offsetting inflows—typically proceeds from bonds—are considered "other financing sources" instead of revenues.

This is a special revenue fund.

These are capital projects funds.

No debt service or permanent funds qualified as major.

The reconciliation for this statement is presented on a separate page (see Figure 5). It could also be displayed here, as in Figure 3.

Did this local government balance its inflows and outflows in the short run? When general fund revenues, expenditures, and other financing sources (uses) are added together, there is a shortfall of \$4.7 million (\$2.7 million deficiency of expenditures over revenues plus \$2.0 million net other financing uses). Were it not for the capital asset sale, the fund balance of \$1.7 million shown here would have been a *deficit* of \$1.8 million.

Figure 5. Illustrative Reconciliation of Net Change in Governmental Fund Balances to Governmental Activities Change in Net Assets (Separate Page Format)

The reconciliation could also be presented on the face of the statement, as it is for the illustrative balance sheet in Figure 3.

Local City

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities For the Year Ended December 31, 2002

	From the governmental funds statement of revenues, expenditures, and changes in fund balances (Figure 4).	\$ (106,657)
Net change in fund balances—total governmental funds		

Amounts reported for *governmental activities* in the statement of activities are different because (see Note 6 also):

Governmental funds report capital outlays as expenditures.

However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period. 14,039,717

In the statement of activities, only the *gain* on the sale of the parkland is reported, whereas in the governmental funds, the proceeds from the sale increase financial resources. Thus, the change in net assets differs from the change in fund balance by the cost of the land sold. (823,000)

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. 1,920,630

Bond proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount by which proceeds exceeded repayments. (16,140,416)

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. (1,245,752)

Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities. (758,808)

Change in net assets of governmental activities \$ (3,114,286)

The internal service funds are reported in the proprietary funds statements and not the governmental because they are operated like businesses and try to charge a price for goods and services high enough to recoup their costs. However, the nature of the activity (providing essentially support and administrative services to other parts of a government) typically merits their inclusion with the governmental activities.

This is the amount you will find in the government-wide statement of activities (Figure 2).

THE NOTES TO THE FINANCIAL STATEMENTS CONTAIN VALUABLE INFORMATION

- A local government's notes disclose additional information that is essential to representing its financial status accurately and completely—they are an integral part of the financial statements.
- You can learn from the notes, among other things:
 - The approximate cost of using capital assets to provide services
 - Whether any significant finance-related legal or contractual provisions were violated
 - Major financial commitments a local government has made
 - A local government's efforts to manage and limit risk
 - Amounts a local government will be required to raise in the future to repay current outstanding debts
 - A local government's annual pension costs and its net pension obligation
 - Details about the finances of health insurance and other nonpension benefits a local government provides to its retired employees
 - A local government's significant accounting methods and assumptions.

SUPPORTING INFORMATION LOCAL GOVERNMENTS PROVIDE WITH THEIR FINANCIAL STATEMENTS

Management's Discussion and Analysis

- MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A) is a narrative overview of the financial statements, prepared by the finance officials of a local government, that appears before the financial statements.
- MD&A is intended to be an objective, straightforward, and understandable introduction to a local government's financial statements.
- MD&A prepares you to use the financial statements more knowledgeably and capably by:
 - Giving you a summary analysis of a local government's financial health based on the information in the statements
 - Highlighting important financial issues.

Budgetary Comparison Information

- A BUDGETARY COMPARISON SCHEDULE (Figure 6) is provided for the general fund and each major special revenue fund for which a local government legally adopts a budget. Governments have the option to present the budgetary comparison as part of the basic financial statements.
- This schedule compares revenue and expenditure/expense information from the:
 - Originally adopted budget
 - Final modified budget
 - Actual results for the year.
- The information in budgetary comparisons can help you:
 - Judge a local government's compliance with its budget
 - Assess a local government's fiscal management capacity.

Information about Pension Systems

- Some local governments are required to provide information about the financial status of their pension plans. You can use this information to:
 - Determine whether the plan's assets are sufficient to finance the pension benefits current employees and retirees have earned up to this point
 - Compare the pension contributions required from a local government, based on actuarial computations, with the actual amounts it contributed.

Information about the Physical Condition of Infrastructure

- Some local governments are required to provide information about their bridges, roads, and other INFRASTRUCTURE assets. You can use this information to determine:
 - If the condition of infrastructure is improving or deteriorating
 - How the estimated cost of maintaining infrastructure assets compares to what a local government actually spent.

OTHER INFORMATION YOU MAY GET WITH THE FINANCIAL STATEMENTS

- Many local governments include their basic financial statements in a **COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)**, where you can find additional supporting information such as:
 - Statements and schedules that offer more detailed data than is included in the basic financial statements
 - Financial, economic, and demographic data that you may find useful for analyzing financial statements.

BACKGROUND: WHERE DO FINANCIAL STATEMENT RULES COME FROM?

- The accounting and financial reporting standards that state and local governments follow are established by the Governmental Accounting Standards Board.
 - The GASB is a private, nonpartisan, nonprofit organization founded under the auspices of the Financial Accounting Foundation (FAF), which appoints the GASB's board, raises its funds, and oversees its activities. The FAF performs the same functions for the GASB's counterpart for the private sector, the Financial Accounting Standards Board.
 - The GASB was created by agreement of the FAF and the American Institute of Certified Public Accountants (AICPA); the Council of State Governments; the Government Finance Officers Association; the International City/County Management Association; the National Association of Counties; the National Association of State Auditors, Comptrollers and Treasurers; the National Conference of State Legislatures; the National League of Cities; the National Governors' Association; and the U.S. Conference of Mayors.
- The GASB is composed of a full-time chair and six part-time members drawn from various parts of the GASB's constituency—state and local government finance officers and auditors, the accounting profession, academia, and persons who use financial statement information.
- The GASB does not have the power to enforce compliance with the standards it promulgates, but:
 - The authority for its standards is recognized under the Rules of Conduct of the AICPA.
 - Legislation in many states requires compliance with GASB standards.
 - Governments usually are expected to prepare financial statements in accordance with those standards (often referred to as **GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**, or **GAAP**) when they issue bonds or notes or otherwise borrow from public credit markets.

Figure 6. Illustrative Budgetary Comparison Schedule

	Local City									
	Budgetary Comparison Schedule for the General Fund									
	For the Year Ended December 31, 2002									
	Budgeted Amounts		Actual Amounts		Original		Positive (Negative)		Budget	
	Original	Final	Budgetary Basis	Final to Actual	Original to Final	Original to Final	Final to Actual	Reconciliation	to GAAP	Actual Amounts
										GAAP Basis
REVENUES										
Property taxes	\$ 52,017,833	\$ 51,853,018	\$ 51,173,436	\$ (679,582)	\$ (164,815)	\$ (679,582)	—	—	—	\$ 51,173,436
Other taxes—franchise and public service	12,841,209	12,836,024	13,025,392	189,368	(5,185)	189,368	—	—	—	13,025,392
Fees and fines	718,800	718,800	606,946	(111,854)	—	(111,854)	—	—	—	606,946
Licenses and permits	2,126,600	2,126,600	2,287,794	161,194	—	161,194	—	—	—	2,287,794
Intergovernmental	6,905,898	6,571,360	6,119,938	(451,422)	(334,538)	(451,422)	—	—	—	6,119,938
Charges for services	12,392,972	11,202,150	11,374,460	172,310	(1,190,822)	172,310	—	—	—	11,374,460
Interest	1,015,945	550,000	552,325	2,325	(465,945)	2,325	—	—	—	552,325
Miscellaneous	3,024,292	1,220,991	881,874	(339,117)	(1,803,301)	(339,117)	—	—	—	881,874
Total revenues	91,043,549	87,076,943	86,022,165	(1,056,778)	(3,964,606)	(1,056,778)	—	—	—	86,022,165
EXPENDITURES										
Current:										
General government	11,837,534	9,468,155	8,621,500	846,655	2,369,379	846,655	—	—	9,335	8,630,835
Public safety	33,050,966	33,983,706	33,799,709	183,997	(932,740)	183,997	—	—	(70,086)	33,729,623
Public works	5,215,630	5,025,848	4,993,187	32,661	189,782	32,661	—	—	(17,412)	4,975,775
Engineering services	1,296,275	1,296,990	1,296,990	—	(715)	—	—	—	2,655	1,299,645
Health and sanitation	5,756,250	6,174,653	6,174,653	—	(418,403)	—	—	—	(104,621)	6,070,032
Cemetery	724,500	724,500	706,305	18,195	—	18,195	—	—	—	706,305
Culture and recreation	11,059,140	11,368,070	11,289,146	78,924	(308,930)	78,924	—	—	122,539	11,411,685
Education—payment to school district	22,000,000	22,000,000	21,893,273	106,727	—	106,727	—	—	—	21,893,273
Total expenditures	90,940,295	90,041,922	88,774,763	1,267,159	898,373	1,267,159	—	—	(57,590)	88,717,173
Excess (deficiency) of revenues over expenditures	103,254	(2,962,979)	(2,752,598)	210,381	(3,066,233)	210,381	—	—	57,590	(2,695,008)
OTHER FINANCING SOURCES (USES)										
Transfers in	939,525	130,000	129,323	(677)	(809,525)	(677)	—	—	—	129,323
Transfers out	(2,970,256)	(2,163,759)	(2,163,759)	—	806,497	—	—	—	—	(2,163,759)
Total other financing sources and uses	(2,030,731)	(2,033,759)	(2,034,436)	(677)	(3,026)	(677)	—	—	—	(2,034,436)

Some governments refer to this as "favorable (unfavorable)."

This budgetary comparison is prepared as a schedule in the government's required supplementary information. Governments have the option to present it with the basic financial statements instead.

SPECIAL ITEM	1,355,250	3,500,000	3,476,488	2,144,750	(23,512)	---	3,476,488
Proceeds from sale of park land							
Total other financing sources (uses) and special items							
Net change in fund balance	(572,227)	(1,496,738)	(1,310,546)	(924,511)	186,192	57,590	(1,252,956)
Fund balances—beginning	3,528,750	2,742,799	2,742,799	(785,951)	---	165,523	2,908,322
Fund balances—ending	<u>\$ 2,956,523</u>	<u>\$ 1,246,061</u>	<u>\$ 1,432,253</u>	<u>\$ (1,710,462)</u>	<u>\$ 186,192</u>	<u>\$ 223,113</u>	<u>\$ 1,655,366</u>

Explanation of differences:

(1) The City budgets for claims and compensated absences only to the extent expected to be paid, rather than on the modified accrual basis.

Encumbrances for goods and services ordered but not received are reported as expenditures in the year *the orders are placed* for budgetary purposes, but are reported in the year the goods and services are *received* for GAAP purposes.

Net increase in fund balance—budget to GAAP

\$ 57,590

186,690

\$ (129,100)

(2) The amount reported as "fund balance" on the budgetary basis of accounting derives from the basis of accounting used in preparing the City's budget. (See Note 1 for a description of the City's budgetary accounting method.) This amount differs from the fund balance reported in the statement of revenues, expenditures, and changes in fund balances because of the cumulative effect of transactions such as those described above.

Governments have some leeway to decide how best to present the reconciliation, just as they do for the reconciliations in the governmental funds statements (Figures 3, 4, and 5). One option would be to present the reconciliation on the page following the comparison schedule. The level of detail in the reconciliation may also vary, depending upon the need for additional explanation of the difference between the budgetary basis and the modified accrual basis.

Local City presents its schedule using the formal terminology, and classifications of the statement of revenues, expenditures, and changes in fund balances. A government may also use those of its own budget document.

Budgeted amounts include the originally adopted budget (including legal adjustments made prior to the start of the year) and the final budget (with all changes made to the budget subsequent to the start of the year).

Variance columns are not required; governments may include one or both or neither.

- The GASB follows the set of “due process” activities enumerated in its published rules of procedure before issuing its standards. Due process is stringent and designed to permit timely, thorough, and open study of financial accounting and reporting issues by the preparers, attestors, and users of financial reports, in order to encourage broad public participation in the standards-setting process.
 - For many issues it addresses, the GASB appoints an advisory task force of outside experts; studies existing literature on the subject and conducts or commissions additional research if necessary; publishes for public comment a discussion document setting forth the issues and possible solutions; conducts public hearings; and broadly distributes an exposure draft of a proposed standard for public comment.
 - Significant steps in the process are announced publicly. The GASB’s meetings are open to public observation and a public record is maintained.
 - The GASB also is advised by its Governmental Accounting Standards Advisory Council (GASAC), a group appointed by the FAF and representing a wide range of the GASB’s constituents.
- The annual financial statements prepared by state and local governments were revised and improved substantially by standards the GASB enacted in June 1999. These revisions are embodied in GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*.
 - Statement 34 applies to *all* state and local governments, including public colleges and universities, public hospitals and healthcare organizations, public museums and cultural institutions, libraries, public employee retirement systems, and so on.
 - The new standards are the product of 15 years of deliberation by the Board members and research by the GASB staff and consultants. Along the way, the GASB:
 - Exposed four discussion memoranda and three full-fledged drafts to public review and received hundreds of comment letters, both praising and critical, in response
 - Field-tested the new financial statements with 25 state and local governments of various sizes and types from across the country
 - Held dozens of focus groups and public hearings
 - Met regularly with major constituent organizations; established task forces made up of a broad representation of preparers, auditors, and users; and received additional advice from the GASAC.

NOTES