Chapter 11

Issues of Reporting, Disclosure, and Financial Analysis
Learning Objectives

- Conversion of Fund Statements to Government-wide
- Why the make-up of a government’s or not-for-profit’s reporting entity is an issue
- The criteria that the GASB has established to determine the units that constitute a government’s reporting entity
- Various ways of reporting component units
- Reports of special-purpose entities
- Elements of a government’s CAFR
- Critical factors to consider in assessing a government’s financial condition
Government Wide Statements

General Approach to preparing government-wide statements from fund statements:

- Start with a year-end trial balance that combines all of the governmental funds.
- Eliminate all inter-fund transactions.
- Adjust capital asset-related accounts
- Adjust long-term, debt-related accounts
- Adjust for differences in basis of accounting
- Consolidate the internal service fund
- Complete the government-wide trial balance
- Divide the accounts between Statement of Net Assets and Statement of Activities and then among the various functional accounts.
Reporting Entity

Composition of reporting entity

- One of the least tractable issues
- An organization’s legal entity differs from its economic entity.
- Example of common intergovernmental relationships in the US
  - Housing authorities established by cities to provide low cost financing for residents of the cities
  - Turnpike commissions
  - Volunteer fire departments
Criteria for Reporting Entities


- Reporting entity should consist of:
  - primary government and
  - component units.

- Primary government: any state government, general purpose local government, or a special purpose state or local government.

- Special purpose government must:
  - Have a separately elected governing body
  - Be legally separate from primary government and be fiscally independent of other governments
  - Have authority to determine its budget, levy taxes, and issue bonds.
Criteria for Reporting Entities (Cont’d)

Component Unit:
- Legally separate government
- Elected officials of primary government are financially accountable
- Exclusion of component unit might cause the primary government’s statements to be misleading.
  - **Example 1:** State of New York established Municipal Assistance Corporation to help the City of New York during financial difficulties.
  - **Example 2:** Houston Zoo, Greater Houston Convention & Visitors Bureau
  - For reporting purposes, a governmental entity considers a component unit to be major if assets, liabilities, revenues or expenses exceed
    • 10% of that component unit’s class and
    • 5% of all component units combined.
Criteria for Reporting Entities (Cont’d)

- Key criteria as to whether a primary government is financially accountable for another government:
  - The primary government appoints a voting majority of the unit’s governing body (or)
  - A majority of the unit’s governing body is composed of primary government officials.

- In addition, either one of the following criteria must be satisfied.
  - The primary government is able to impose its will upon the potential component unit.
  - The component unit is able to provide specific financial benefits to, or impose specific financial burdens on, the primary government.
Criteria for Reporting Entities (Cont’d)

- General Rule:
  - A component unit is fiscally accountable only if the primary government controls the appointment of its governing board.

- Exception:
  - If a component unit is fiscally dependent on the primary government, it is fiscally accountable even if its governing bodies are not appointed by the primary government.
Reporting Component Units

- **Discrete presentation:**
  - Reporting units in a single column, separate from the data of the primary government.
  - Default means of reporting.

- **Blending:**
  - Transactions treated as part of the primary government.
  - Appropriate when the primary government and the component unit are so closely related and are substantively the same.
Major discretely presented component units for the City of Houston include:
- Fourth Ward Redevelopment Authority
- Houston Arts Alliance (formerly Cultural Arts Cou..)
- Greater Houston Convention and Visitor’s Bureau
- Houston Downtown Park Corporation
- Main Street Market Square Redevelopment Auth
- Upper Kirby Redevelopment Authority
- Midtown Redevelopment Authority
- Uptown Redevelopment Authority
- Total Net Assets of all the discretely presented Governmental Component units (major and nonmajor) for FY 2009 = $13,895,000

Discretely presented Business type Component units (major and nonmajor) for the City of Houston:
- Houston Convention Center Hotel Corporation
- Houston Housing Finance Corporation
- Houston Zoo Inc.
- Nonmajor component units
- The total net assets for FY 2009 = $101,734,000
Required Disclosures

Primary government must disclose detailed information about each major component unit in either of the following:

- Government-wide statements (by presenting the component unit in a separate column)
- Notes to the financial statements
- Combining financial statements (one column for each major component unit)
Other Types of Units

- **Joint Ventures:**
  - A contractual agreement to carry out a common activity, with the participants sharing both risks and rewards.
  - Ex: Dallas and Fort Worth joining together to construct and operate an airport.

- **Related Organizations:** defined by GASB Stmt. #14 as an entity that
  - Satisfies only the financial accountability criterion and not the other two criteria.
  - Do not qualify as a component unit
  - Cannot be incorporated into the primary government’s financial statements.
Other Types of Units (Cont’d)

Examples of Related Organizations for the City of Houston (CAFR FY: 2009):

Ex 1. Metropolitan Transit Authority (“Metro”): The City and Metro have an interlocal agreement covering shared costs of street maintenance/construction and traffic control during the fiscal year ended June 30, 2009. The City received $68.631 million from Metro under this contract in the fiscal year ended June 30, 2009. The breakout was $40.326 million to Capital Projects, $25 million to General Fund, and $3.305 million to Special Revenues. None of these payments were for the prior contract year. In addition, the City paid Metro $1.357 million for transportation services.

EX 2: Trinity River Authority (“TRA”): As described in Note 8C, the City and TRA have a long-term contract under which the City is obligated to pay debt service for certain bonds as well as certain maintenance and operating expenses for a TRA dam and reservoir. During the fiscal year ended June 30, 2009 the City paid $0 for debt service and $2.1 million for maintenance and operating expenses under the terms of the contract.
Other Types of Units (Cont’d)

- **Affiliated Organizations:**
  - Provide assistance (both financial and non-financial) to the associated government
  - The primary government does not appoint the governing boards
  - These organizations are not fiscally dependent on the primary government

- **Examples:**
  - A state university’s development foundation
  - A state university’s football booster club
  - A public school’s parent-teacher association
Other Types of Units (Cont’d)

GASB Stmt. # 39: Requires governments to report certain organizations as discretely presented component units if they are

– legally separate

– Tax exempt and meet all of the following conditions:
  ▪ Economic resources held are for the direct benefit of the primary government or its component units.
  ▪ The primary government or its component units have direct access to the economic resources
  ▪ The economic resources held or received are significant to that primary government.
Comprehensive Annual Financial Report

Popularly known as the CAFR and is divided into three sections:

– Introductory
– Financial
– Statistical
CAFR (Cont’d)

Introductory section:
- Table of contents
- Letter of transmittal
  - Most informative component of the CAFR and comprises of four main sections.
  - Formal transmittal of the CAFR
  - Government profile
  - Information on economic conditions
  - Awards and acknowledgements
- Other important material deemed appropriate by management such as Government Finance Officers Association’s Certificate of Achievement for Excellence in Financial Reporting
Financial Section:

- **Auditor’s report**
  - Provides assurance about the fairness of the financial statements.

- **Management’s Discussion and Analysis (MD&A)**
  - Basic financial statements
    - Government-wide
    - Fund

- **Required supplementary information:**
  - Ex: Budget to actual comparisons
  - Details of pension actuarial valuations

- **Combining statements, individual statements, and schedules**
  - Supplement and support the basic statements
  - Provide details of the nonmajor funds
CAFR (Cont’d)

Statistical section:

- Supplements the financial statements
- Includes five categories of information
  - Financial trends
  - Revenue capacity
  - Debt capacity
  - Demographic and Economic statistics
  - Operating data
Special Purpose Governments

Reporting requirements:

– Must adhere to same reporting and disclosure requirements as general purpose governments.
– Must prepare both government-wide and fund statements if engaged in both business- and governmental-type activities.
– If engaged in only a single governmental program, government-wide and fund statements can be combined.
– If engaged only in business-type activities:
  • only the statements required for enterprise funds are needed
  • also include key elements of the financial section of CAFR.
Requirements for Colleges and Universities

- GASB Stmt. # 34: Colleges and universities should be subject to same reporting requirements as special-purpose entities engaging:
  - only in business-type activities
  - only in governmental activities
  - or in both

- Public colleges and universities follow GASB pronouncements
- Not-for-profit colleges and universities follow FASB pronouncements
Government’s Fiscal Condition

- Assessing a government’s financial condition is a daunting task.

- CAFR is the single richest source of data in assessing the financial condition.
  - Provides only a raw data of relationships and trends
  - Burden of analysis fall upon individual users

- A comprehensive analysis of assessing a city’s fiscal status is provided in Table 11-4 on pages 474-476.
Fiscal Condition (Cont’d)

Factors affecting the fiscal condition:

- **Demographic**
  - Age, income distribution, educational level etc.

- **Economic**
  - Composition of taxpayers, industries in which they work etc.

- **Political**
  - Government structure, political competition, integrity of the officials, political climate etc.

- **Social**
  - Crime rates, percentage of residents owning homes etc.

- **Other factors include:**
  - Population
  - Enterprises
  - Technology
Budget and Financial Statements

- **Budget:**
  - detailed map of fiscal path
  - Analysts must evaluate the integrity of the budget.
  - Reported on cash or near cash basis

- **Financial Statements:**
  - Reported on GAAP basis
  - Less likely to manipulate reported rather than budgeted revenues/expenses
Financial Indicators

- There are no reliable ‘rules of thumb.’
- Governments account for operations in different ways. So, some ratios may not be directly comparable.
- Whether a lower or higher ratio is preferred is not always clear.
- Higher or lower ratio depends upon the stage of maturity.
- Ratios are no better than the underlying numbers.
Issue in interpreting financial indicators:
- Should ratios be based on government-wide, general fund, or a combination of both?
- It depends on why the measure is being calculated and how it will be interpreted.

Fiscal effort:
- Extent to which a government is taking advantage of its fiscal capacity.
- Fiscal effort = \( \frac{\text{Per capita revenue from own sources}}{\text{Median family income}} \)
- OR
  \( \frac{\text{Revenue from own sources}}{\text{Total appraised value of property}} \)
Financial Analysis

Goal of financial analysis:

- Evaluate the ability of a government to provide the services expected of it in the future.
- Preparing pro forma statements
- Identify key risks and uncertainties
- Examine a number of ‘what if’ situations
Summary

- Governments typically maintain their accounts on a fund basis. At year end they convert the accounts from a fund (modified accrual) basis to a government-wide (full accrual) basis.
- According to GASB, a primary government should include a potential component unit in its reporting entity if the unit is financially accountable to it.
- The Basic financial statements consist of the two government-wide statements (the statement of net assets and statement of activities) and the fund statements for each of the three group of funds.
- Special-Purpose governments must prepare the same financial statements as general-purpose governments.
- In assessing a city’s fiscal condition, analysts should consider the current environment in which a government operates.