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Common Reporting Deficiencies

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Common Deficiencies in Government Financial Statements



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Half Truths

- A legally separate entity should be included as a component unit if there is an ongoing relationship of financial benefit or burden
- Revenues should be recognized in governmental funds as soon as amounts become available
- All legal requirements need to be met before revenue from an expenditure driven grant can be recognized
- The difference between internal service funds and enterprise funds is that the former serve internal customers whereas the latter serves external customers.

Half Truths

- Interest expense on tax exempt debt should be capitalized net of interest revenue on the reinvested proceeds.
- Governmental funds should not report land, buildings equipment, and similar assets.
- Derivatives should be reported at fair value.
- Disaster losses should be netted against recoveries.
- Encumbrances should be included in assigned fund balance.



Half truths

- Revenues that must be used for a specific program or function are properly classified as “program revenues”
- Segment disclosure requires that condensed financial statements be provided in the notes to the financial statements for each segment.
- Deficits in individual funds need to be disclosed in the notes to the financial statements
- Condensed financial statements should include a statement of cash flows.



Half Truths

- Governmental funds should be classified as major if they meet both the 10 percent and 5 percent tests.
- Trust funds do not report liabilities to beneficiaries
- The number of funds principle means the fewer the funds the better
- Data from fiduciary type component units should be blended
- Liabilities should be recognized in governmental funds only if they are due and payable.

Half truths

- Operating subsidies to component units should be reported as transfers
- A special item is a transaction or event that meets just one of the two criteria for an extraordinary item.
- Long term borrowing within the government should be reported as a fund liability, rather than as an other financing source.
- Transactions with discretely presented component units should be treated just like transactions with outside parties.

Half Truths

- The application of the proceeds of refunding debt should be reported as an other financing use.
- The government has the option to voluntarily classify a given fund as major.
- Interest capitalization is required in proprietary funds



Common Deficiencies in Government Financial Statements: MD&A

Management Discussion and Analysis:

1. Placing the MD&A in front of the auditor's opinion.
2. **Presenting additional information beyond the eight required elements. (GASB 34, paragraph 11)**
3. Including unnecessary information in the initial description of the basic financial statements, for example, descriptions of nonmajor funds, definitions of fund types, etc.



Common Deficiencies in Government Financial Statements: MD&A

4. **Reporting only the amount or percentage of the changes up or down, not the reasons for the change. Must discuss why the numbers have changed since last year.**
5. **Failing to present all of the required information in the summarized government-wide financial data in tables as discussed in GASBS No. 34, paragraph 11b. (14)**
6. **Presenting charts and graphs that do not assist in the analysis. Many governments present pie charts showing the sources of the revenues or the types of expenditures. The government should focus instead on the changes in the sources of revenues or the focus of MD&A should be on changes.**

Common Deficiencies in Government Financial Statements: MD&A

7. **Failing to present three years of data in the MD&A when comparative basic financial statements are presented. (Comparative financial statements are not required, however, if you do, then you must show three years of data in the condensed financial summary (GASB 34, paragraph 11b))**
8. Putting information in the MD&A that is not also discussed in the notes. If necessary, refer readers of MD&A to the notes. For example, several governments stated that they planned to implement the retroactive infrastructure reporting requirements at a future date, but did not mention this in the note discussion of capital assets. The notes must contain a transitional paragraph discussing the implementation of retroactive infrastructure in addition to discussion in the MD&A.
9. If the MD&A is missing, or has significant deficiencies in it (for example, only 4 of the eight required elements in paragraph 11 are presented), then the auditor must disclose these problems in the auditor's report. More information on handling these problems is found in AICPA AU 558.08.



Common Deficiencies in Government Financial Statements: MD&A

10. Budget Analysis

Failure to focus on variations. Original budget vs. final budget Final budget vs. actual.

Inclusion of funds other than general fund.



Common Deficiencies : Measurement Focus/Basis of Accounting Issues

Measurement Focus/Basis of Accounting Issues

1. Capitalizing interest expense on governmental capital assets. GASB 37 amended GASB 34 to prohibit this capitalization. Only proprietary and fiduciary funds will capitalize interest on capital assets.
2. Failure to convert inventory from the purchases method to the consumption method in the government-wide financial statements, when inventory balances are material. Consumption based inventory must be presented at the government-wide level.



Common Deficiencies : Measurement Focus/Basis of Accounting Issues

3. Including the government's assets and liabilities in agency funds. Only assets belonging to third parties should be accounted for in the agency funds. Assets and liabilities belonging to the government should be reported in the government's funds. (There are other problems with counties and constitutional officers who have not made year-end transfers to their respective governments.)
4. Payments in lieu of taxes should only be reported when there is a payment for specific services required. PILOTs that do not meet this test should be reported as transfers (Most payments by enterprise funds to government funds are probably transfers!)



Common Deficiencies : Measurement Focus/Basis of Accounting Issues

5. **Failure to recognize liabilities for salaries, wages, and similar operating liabilities in their entirety in the governmental funds (GASB Interpretation 6). Other liabilities may be recognized when due and payable from current resources such as claims and judgments, compensated absences, landfill closure, pensions, and termination benefits. If these other liabilities are not to be paid from current resources, then they are not presented as fund liabilities, rather they will be reported on the government-wide level. As such, these other liabilities should appear as reconciling items between the governmental fund balance sheet and the government-wide statement of net assets.**

Failure to break out current portion of compensated absences



Common Deficiencies : Measurement Focus/Basis of Accounting Issues

6. Reporting property tax revenues in governmental funds when they are available but before the period in which they are legally allowed to be spent. For example, a government accrues a receivable for property taxes at September 30, 2014 for tax bills that will be going out in October 2014 for the fiscal year beginning October 1. The debit is to property tax receivable and the credit is to deferred revenue (since it is unearned at September 30). Since any taxes collected in October and November can only be spent in the new fiscal year, there is no period of availability for September 30, 2014.

Common Deficiencies : Measurement Focus/Basis of Accounting Issues

7. Reporting items as “extraordinary” and “special items” transactions that are not significant or that do not meet the GAAP definitions of those terms. Also, reporting those items at only one level when the transactions are significant to both government-wide and fund financial statements.



Common Deficiencies : Government-Wide Statements

Government-wide Statements

1. **Reporting prior period adjustments that are insignificant.**

Also, there is evidence that some auditors prefer to “correct the prior auditor” over interpretations of GAAP when there is not really an error in the prior period financial statements. Auditors proposing prior period adjustments need to follow SAS 84 have communicate these proposals to the prior auditor and the client.



Common Deficiencies : Government-Wide Statements

2. **Not distinguishing between capital assets that are being depreciated and those that are not when those not being depreciated, such as land, construction in progress, collections, and modified approach to infrastructure. It is not acceptable to report only one line-capital assets, net if there are material amounts of nondepreciable capital assets included.**
3. **Reporting long-term liability amounts due within one year only for formal debt issues. This requirement applies to all long-term liabilities (including operating liabilities), not just formal debt issues.**

Not reporting the break down of “payable within one year” and amount due in more than one year” when doing the relative order of liquidity presentation.



Common Deficiencies : Government-Wide Statements

4. **Reporting lines or columns on the statements without any amounts.**
5. Reporting amounts that are “reserved fund balances” in the governmental funds as restricted net assets in the government-wide statements. For example, inventory balances are reserved in the governmental fund balance sheet because they are not available financial resources, but they do not meet the definition of a restricted net asset. Additionally, long-term advances between governmental and business-type activities, and component units are reserved fund balances, but not restricted net assets.
6. **Reporting internally designated fund balances as restricted net assets. Only those restricted net assets that were created by enabling legislation can be reported as restricted net assets.**



Common Deficiencies : Government-Wide Statements

7. Can not report a function as “miscellaneous” or “other”. All expenses must be reported as a direct expense of some function or identifiable activity for Business Type Activities.
8. Revenues from exchange transactions should be reported as program revenues (if meeting the definition of program revenue), not as miscellaneous in the general revenues section.
9. **Gains when material should be shown as General Revenue. Losses should be shown as direct expenses. Only when gains and losses meet the criteria as special items can they be shown as such.**

Common Deficiencies : Government-Wide Statements

10. All depreciation expense for capital assets should be allocated as a direct expense of functions or identifiable activities. (Only depreciation expenses for capital assets that essentially serve all functions and for general infrastructure assets are exempt from this requirement.
- All interest on general long-term debt should be reported as a separate function in the statement of activities. GASBS No. 34, paragraph 46, generally prohibits these costs from being reported as a direct expense of any governmental function.
- Failure to separately report transactions and balances with trust funds and component units that are fiduciary in nature. They should not be reported as part of the governments interfund balances and transfers.



Common Deficiencies : Government-Wide Statements

13. Not distinguishing between major categories of restricted net position on the face of government-wide statement of net net position. Disclosure of this information only in the notes violates GASBS No. 34, paragraph 32 (debt service, grants, donations, enabling legislation, etc.)
14. Failure to report business type activities by “different identifiable activities”, For example, if the government has a combined water and sewer fund at the fund level and the government keeps records of the revenues and expenses for the water activities separate from the sewer activities, then they must be reported separately at the government-wide level. In a smaller government where the records are not kept separate then they may be combined on the government-wide level.



Common Deficiencies : Government-Wide Statements

- **Calculation of net position**
 - **Net Investment in Capital Assets**
 - **Need to exclude**
 - Unexpended proceeds of capital related debt
 - Receivables
 - Debt service reserves
 - Equity in joint ventures
 - Non capital long term debt – compensated absences
 - **Need to include**
 - Discounts and premiums on long term debt
 - Debt service reserves



Common Deficiencies : Government-Wide Statements

- **Calculation of net position**
 - **Debt should exclude**
 - **Accrued interest**
 - **Internal borrowings**
 - **Debt associated with capital assets of another entity**
 - **Debt associated with capital assets that is not reported in the same column**
 - **Debt used to initially fund a debt service reserve**



Common Deficiencies : Government-Wide Statements

- **Misclassification of franchise fees**
 - Should be reported as general revenues
- **Detail on taxes**
 - Single line acceptable however as long as sufficient detail is provided as a separate schedule or in the notes
- **Reporting expenses by functional**
 - Reporting objects of expenditure separate from functional (i.e. subsidies to component units)



Common Deficiencies : Fund Financial Statements

Fund Financial Statements

1. Putting combining information for component units in the format of governmental fund financial statements, rather than government-wide financial statement format.



Common Deficiencies : Fund Financial Statements

3. Presenting an opinion on two years but not providing two years of notes.
4. Presenting comparative statements and not properly labeling the statement as comparative.
5. Failure to report propriety fund revenues by major source on the face of the statement of revenues, expenses, and changes in fund net assets and to separately identify those revenues used as security for revenue bonds.
6. **Reporting bad debt expense in the proprietary fund (and government-wide) statements. Revenues should be reported net of all discounts and allowances, including allowances for bad debts (GASBS No.34, footnote 41).**



Common Deficiencies : Fund Financial Statements

7. Reporting internally designated net assets for proprietary funds as restricted. Restricted net position must meet the definition in GASB 34 for third party and enabling legislation.
8. Not labeling internal service fund columns as either governmental or business-type activities.
9. **Continuing to report “due to” and “due from”, as well as “advances” and “interfund loans” in the entity wide financial statements. GASB 34 replaced these with interfund balances or internal balances. Noncurrent interfund balances should be disclosed in the notes, not on the face of the statement.**



Common Deficiencies: Reconciliations of Fund Financial Statements to Government-Wide Financial Statements

Reconciliations of Fund Financial Statements to Government-wide Statements

1. Failure to report the details of any amounts that have been netted on the reconciliation. For example, if reporting the net effect of capital outlay eliminated and depreciation added, then both amounts must be disclosed on the reconciliation, or as an alternative in the notes.
2. If the government wants to summarize the details of the reconciliation on the face of the statement (or a separate page), then the details must be disclosed in the notes.

Common Deficiencies: Notes

Notes

1. **Not eliminating old disclosures that no longer apply, for example, providing the old definitions of fund types, saying that fiduciary funds use the modified accrual basis, discussing “memorandum only” total columns, or saying that infrastructure is of value only to the government.**
2. Not discussing inventory methods for the government-wide financial statements, when material. For example, first-in, first-out, or average cost, etc.

Common Deficiencies: Notes

3. Stating that the effect of all interfund activity has been eliminated from the government-wide financial statements. However, interfund services provided and used are not eliminated. Except in limited situations, payments in lieu of taxes are treated as transfers in the government-wide statements and eliminated in the total primary government column.
4. Failure to report descriptions on the entity's major funds, internal service fund activities, and fiduciary fund types as required by GASB 38.
5. Including definitions of non-major funds or of internal service funds (should report internal service fund activities, such as self-insurance, motor pool, print shop, etc, but not the names of the funds.)

Common Deficiencies: Notes

6. **Failure to define the three categories of Net Position as Summary of Significant Accounting Policies (SSAP), GASB 34, para 32.**
7. **Failure to report entity specific definitions of operating revenues and expenses for proprietary funds.**
8. Omitting the GASBS No. 38, paragraph 7, required disclosure about the time period used to define “available” for purposes of governmental fund revenue recognition. Most governments use a 60-day period of availability for all revenues, however, this can be modified to fit specific circumstances.

Common Deficiencies: Notes

9. Stating that the government-wide statements are prepared using both GASB as well as FASB pronouncements issued through November 30, 1989. GASB 62 removed this requirement
10. Only discussing the effect of transactions on fund balances and ignoring the government-wide level reporting.
11. **Omitting long-term operating liabilities from the schedule of changes in long-term liabilities GASBA No. 34, paragraph 119.**
12. **Omitting information about how long-term operating liabilities related to governmental funds have been paid in the past (GASBS No. 34, paragraph 119d). Or, instead, disclosing how the government expects to pay those liabilities in the future.**

Common Deficiencies: Notes

13. **Failing to disclose increases and decreases in all long-term liabilities, including compensated absences.**
14. **Not stating the government's policy on first use of restricted resources (often applies in grant situations, not just endowments). Generally, restricted resources should first be applied to the most restricted grants, then less restrictive grants then finally to budgetary restrictions.**
15. Budget related notes should accompany RSI when budgetary comparison schedules are presented, not remain in notes.
16. Including notes that are not specific to the government, as discussed in GASBS No. 38, paragraph 8, for example, defining "extraordinary" and "special" when neither are reported. Also should not defining fiduciary fund types that are not used. Focus instead on the entity specific disclosures required by GASBS No. 38.



Common Deficiencies: Notes

17. **Not discussing describing “extraordinary” or “special” items in the notes to the financial statements. If they meet the definition of either extraordinary or special, then they need a note disclosure.**
18. Disclosing segment information that is identical to major enterprise fund columns. Using old definitions of segment (NCGA Statement 2). Segment information is only required for NON-MAJOR enterprise funds that have bonds outstanding where the revenues of the activity are pledged to those bonds AND there is a requirement to issue separate financial statements (balance sheet and income statement) on this enterprise fund activity (should not be common).
19. Putting “detail” about reconciling items in the notes that are identical to the reconciliations presented on the face of the fund statements.

Common Deficiencies: Notes

20. **Omitting the purpose for interfund balances and transfers, required by GASBS No. 38, paragraphs 14b and 15b, respectively.**
21. **Omitting the disclosure of any interfund balances that are not going to be repaid within the year.**
22. Omitting information about the schedule of changes in short-term debt and the purpose of the debt.
23. Omitting disclosures about the amount of depreciation expense charged to each function in the government-wide statements of activity (GASBS No. 34, paragraph 117d). (NEED to do this for both Governmental Activities and Business Type Activities).

Common Deficiencies: Notes

- **No summary of significant accounting policies addressing operating vs. nonoperating revenues for proprietary fund statements**
- **No break down of employer contributions to separate pension plans. Usually done in one single amount.**

Common Deficiencies: Notes

- Debt service requirements to maturity were not disclosed
- **Accounting policy with respect to receivables, the allowance for doubtful accounts and the allowance itself were not disclosed.**
- Criteria used for determining component units were not disclosed
- Audited entity expensed property acquired with federal or state grants
- **Pension disclosures were not adequate.**

Common Deficiencies: Notes

- If applicable – not disclosing the highest authority that can commit fund balance
- Not disclosing the order of the use of restricted fund balance as required by GASB 54 or stating the order if not formal policy



Common Deficiencies: Required Supplementary Information (RSI)

Required Supplementary Information (RSI)

1. **Budget related notes should accompany RSI, not remain in notes.**
2. **Budgetary schedules should be confined to those that are for the general fund and major special revenue funds.** It is never appropriate to present additional information in RSI-for example by presenting budgetary comparison schedules for capital projects funds or enterprise funds. Conversely, some governments have presented a comparison schedule for only the general fund when other major special revenue funds have legally adopted budgets.
3. Failing to provide budgetary comparison schedules/statements for special revenue funds that the government elects to report as major funds.



Common Deficiencies: Required Supplementary Information (RSI)

- **No disclosure of basis of budgeting**
- Inclusion of extraneous information
 - i.e. budgetary comparisons for non major funds

Combining/individual funds

- **Failure to demonstrate legal compliance**
 - **Not reporting at the legal compliance level**
- **Showing blended component units as a single type activity instead of individual funds**

QUESTIONS

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