

Common Deficiencies in Government Financial Statements



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May 2015



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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.



Half Truths

- 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 debt should be capitalized net of interest revenue on the reinvested proceeds.
- Interest capitalization is required in proprietary funds.
- Governmental funds should not report land, buildings, equipment, and similar assets.



Half Truths

- Disaster losses should be netted against recoveries.
- Encumbrances should be included in assigned fund balance.



Half Truths

- All revenue that must be used for a specific program or function are properly classified as “program revenues”.
- Deficits in individual funds need to be disclosed in the notes to the financial statements.

Half Truths

- Governmental funds should be classified as major if they meet both the 10 percent and 5 percent tests.
- The number of funds principle means the fewer the funds the better.
- The government has the option to voluntarily classify a given fund as major.

Half Truths

- Operating subsidies to component units should be reported as transfers.
- 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 use of the proceeds of refunding debt should be reported as an other financing use.
- A special item is a transaction or event that meets just one of the two criteria for an extraordinary item.

Common Deficiencies: 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.

Common Deficiencies: MD&A

4. Reporting only the amount or percentage of the changes up or down, not the reasons for the change.
5. Failing to present all of the required information in the condensed 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.

Common Deficiencies: MD&A

7. Failing to present three years of data in the MD&A when comparative basic financial statements are presented.
8. Putting information in the MD&A that is not discussed in the notes. If necessary, refer readers of the MD&A to the notes.
9. If the MD&A is missing or has significant deficiencies in it, the auditor must disclose these problems in the auditor's report.

Common Deficiencies: MD&A

10. Budget Analysis - Failure to focus on reasons for variations

Original budget vs. final budget

Final budget vs. actual

11. Failure to explain any discrepancy in comparative data that results from a prior period adjustment.

- *net position* end of prior year $\neq$ *net position* start of current year



Common Deficiencies: Measurement Focus/ Basis of Accounting

Measurement Focus/Basis of Accounting Issues

1. Capitalizing interest expense on governmental capital assets.
2. Failure to convert inventory from the purchase method to the consumption method in the government-wide financial statements, when inventory balances are material.
3. Including the government's assets and liabilities in agency funds.



Common Deficiencies: Measurement Focus/ Basis of Accounting

4. 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.
5. Failure to break out current portion of compensated absences.
6. Recognizing property tax revenues in governmental funds when they are available but before the period in which they are legally allowed to be spent.



Common Deficiencies: Measurement Focus/ Basis of Accounting

7. Reporting items as “extraordinary” and “special items” transactions that are not significant or that do not meet the GAAP definitions of those terms.
8. 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.
2. Not distinguishing between capital assets that are being depreciated and those that are not.
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.



Common Deficiencies: Government-Wide Statements

4. Reporting lines or columns on the statements without any amounts.
5. Cannot report a function as “miscellaneous” or “other”. All expenses must be reported as a direct expense of some function or identifiable activity.
6. 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.



Common Deficiencies: Government-Wide Statements

7. Misclassification of franchise fees - should be reported as general revenues.
8. Gains when material should be shown as general revenue. Losses should be shown as an expense of the general government.
9. All depreciation expense for capital assets should be allocated as a direct expense of functions or identifiable activities.



Common Deficiencies: Government-Wide Statements

10. All interest on general long-term debt should be reported as a separate function in the statement of activities.
11. Not distinguishing between major categories of restricted net position on the face of government-wide statement of net position.



Common Deficiencies: Government-Wide Statements

12. Failure to report business-type activities by “different identifiable activities”.
13. Incorrect calculation of net position:
 - Net Investment in Capital Assets need to exclude
 - Unexpended proceeds of capital related debt
 - Debt service reserves
 - Non capital long term debt
 - Need to include
 - Discounts and premiums on long term debt



Common Deficiencies: Government-Wide Statements

14. Calculation of net position (continued)

- 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: Deferred Outflows/ Inflows

1. Include items not specifically identified as such by GASB.
2. Netting against similar deferred amounts.
3. Netting refunding debt against the unamortized gain/loss.



Common Deficiencies: Incomplete Transition to New Terminology

- Remove any remaining references in the financial statements to:
 - *Net assets*
 - *Investment in capital assets, net of related debt*
 - *Deferred revenue*



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.
2. Presenting an opinion on two years but not providing two years of notes.



Common Deficiencies: Fund Financial Statements

3. Presenting comparative statements and not properly labeling the statement as comparative.
4. Failure to report proprietary fund revenues by major source on the face of the statement of revenues, expenses, and changes in fund net position.
5. 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. Not labeling internal service fund columns as either governmental or business-type activities.
8. Continuing to report “due to” and “due from” as well as “advances” and “interfund loans” in the government-wide financial statements.



Common Deficiencies: Fund Balance

- Disclose at a level of detail lower than by function if limitation is narrower
 - *Public safety vs. fire vehicles and equipment*
- Report the purpose of encumbrances rather than the encumbrances themselves
 - *Equipment purchases vs. encumbrances*



Common Deficiencies: Fund Balance

- Do not report *committed fund balance* for appropriations
 - Appropriations automatically lapse
 - Appropriations = authorization to spend vs. limitation on spending



Common Deficiencies: Fund Balance

- Describe what *assigned fund balance* actually is, rather than its mathematical relationship to other fund balance components
 - Not simply “excess of total fund balance over non-spendable, restricted, and committed amounts” in funds other than the general fund



Common Deficiencies: Fund Statements to Government-Wide 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.
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

Footnotes

1. Not eliminating old disclosures that no longer apply.
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. Failure to report descriptions of the government's major funds, internal service fund activities, and fiduciary fund types as required by GASB 38.
4. Including definitions of non-major funds or internal service funds.

Common Deficiencies: Notes

5. Failure to define the three categories of Net Position in the Summary of Significant Accounting Policies (SSAP), GASB 34, para 32.
6. Failure to report government specific definitions of operating revenues and expenses for proprietary funds.
7. Omitting the GASBS No. 38, paragraph 7, required disclosure about the time period used to define “available” for purposes of governmental fund revenue recognition.

Common Deficiencies: Notes

8. Only discussing the effect of transactions on fund balances and ignoring the government-wide level reporting.
9. Omitting long-term operating liabilities from the schedule of changes in long-term liabilities GASBS No. 34, paragraph 119.
10. 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

11. Failing to disclose increases and decreases in all long-term liabilities, including compensated absences.
12. Not stating the government's policy on first use of restricted resources.
13. 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: Notes

14. Budget related notes should accompany RSI when budgetary comparison schedules are presented, not remain in notes.
15. Including notes that are not specific to the government, as discussed in GASBS No. 38, paragraph 8.
16. Not discussing “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.

Common Deficiencies: Notes

17. Disclosing segment information that is identical to major enterprise fund columns.
18. Putting “detail” about reconciling items in the notes that are identical to the reconciliations presented on the face of the fund statements.
19. Omitting the purpose for interfund balances and transfers, required by GASBS No. 38, paragraphs 14b and 15b, respectively.

Common Deficiencies: Notes

- 20. Omitting the disclosure of any interfund balances that are not going to be repaid within the year.
- 21. Omitting information about the schedule of changes in short-term debt and the purpose of the debt.
- 22. Omitting disclosures about the amount of depreciation expense charged to each function in the government-wide statements of activity (GASBS No. 34, paragraph 117d).

Common Deficiencies: Notes

- 23. No break down of employer contributions to separate pension plans. Usually done in one single amount.
- 24. Debt service requirements to maturity were not disclosed.
- 25. Accounting policy with respect to receivables, the allowance for doubtful accounts and the allowance itself were not disclosed.

Common Deficiencies: Notes

- 26. Criteria used for determining component units were not disclosed.
- 27. Pension disclosures were not adequate.
- 28. Not disclosing the highest authority that can commit fund balance (If applicable).
- 29. Not indicating that a positive balance of *unassigned fund balance* can be reported only in the general fund.

Common Deficiencies: Notes

- 30. Failure to specify the type of infrequent circumstances or conditions that would need to occur to authorize spending stabilization funds.
- 31. Disclose the core revenue source(s) for each major special revenue fund.

Common Deficiencies: Notes

32. Commonly missing revenue bond disclosures (GASB Statement No. 48, paragraph 21):

- Specific revenue pledged
- Approximate amount of the pledge
- Identification of the secured debt
- General purpose of the secured debt
- Period revenue will not be available for other purposes
- Proportion of the specific revenue stream that has been pledged
- Comparison of: 1) pledged revenues recognized during the period; and 2) principal and interest requirements for the collateralized debt



Common Deficiencies: RSI

Required Supplementary Information (RSI)

- Budget related notes are in the footnotes rather than with the RSI.
- Budgetary schedules include funds other than the general fund and major special revenue funds.
- Failing to provide budgetary comparison schedules for special revenue funds that the government elects to report as major funds.
- No disclosure of basis of budgeting.

QUESTIONS



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