

CHAPTER 8 – Financial Reporting

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OVERVIEW

Financial reporting is not an end in itself, but a useful tool in providing the necessary information needed by the citizenry and other users who have limited authority, ability, or resources to obtain information. The overall goal of financial reporting (and accounting) for governments is to provide:

- Financial information useful for making economic, social, and political decisions and demonstrating accountability and stewardship.
- Information useful for evaluating managerial and organizational performance.

The paramount objective of a government is accountability. Accountability is defined in the standards as:

The requirement of a government to answer to the citizenry—to justify the raising of public resources and the purposes for which they are used.

To meet these goals and objectives, financial reporting should assist the users in evaluating the government. To accomplish this, the financial reports should:

- Provide information to determine whether current-year revenues were sufficient to pay for current-year services.
- Demonstrate whether resources were obtained and used in accordance with the entity's legally adopted budget.
- Demonstrate compliance with other finance-related legal or contractual requirements.
- Provide information to assist users in assessing the service efforts, cost, and accomplishments of the governmental entity.
- Provide information about sources and uses of financial resources, including the identification of material nonrecurring financial transactions.
- Provide information about how the governmental entity financed its activities and met its cash requirements.
- Provide information necessary to determine whether the entity's financial position improved or deteriorated as a result of the year's operations.
- Provide information about the financial position and condition of a governmental entity.
- Provide information about a governmental entity's physical and other nonfinancial resources having useful lives that extend beyond the current year.

- Disclose legal or contractual restrictions on resources and risk of potential loss of resources.

The information presented in financial reports will also depend on the needs of the users. There are three primary users of external state and local governmental reports:

- The citizenry to whom government is primarily accountable.
- Legislative and oversight bodies that directly represent the citizens.
- Investors and creditors, e.g., securities underwriters and bond insurers.

With external financial reporting a primary objective of a government, the accounting system must be designed to provide the essential information to meet this objective. Therefore, a financial objective can directly influence the accounting system from which the information is derived.

Financial statements and reports are end products of the reporting process. Certain information is better reported in the financial statements, while other information is better reported, or can only be reported, using alternative reporting formats.

Financial statements prepared by governments are the core of financial reporting and the principal means of communicating financial information to external users. Governments may also choose, or are required, to report through other types of financial reporting. Budgets filed with grantor agencies are examples of other types of financial reports and may include financial statements, other financial information, and nonfinancial information. These reports are generally used to:

- Meet specific legal or contractual requirements.
- Present financial information in prescribed formats.
- Report specific elements, accounts, or items taken from the basic financial statements.

Since financial reporting is the primary means of communicating information to the users, certain basic characteristics are considered necessary for effectiveness. They are identified in the standards as:

- Understanding—Reports should be presented as simply as possible.
- Reliability—Reports should be fairly stated, verifiable, and free from bias.
- Relevance—Reports should meet the needs of the users.
- Timeliness—Reports must be issued soon enough to be of benefit to the users.

- Consistency—Reports should be prepared using the same accounting principle or reporting method for all similar transactions and events from one period to another.
- Comparability—Reports should help users make comparisons of different governments that perform the same functions or operations.

In the state of Washington, several types of financial reports are required. In addition to the required financial reports, districts may choose to prepare additional financial reports.

BUDGETS

Comparing Actual Financial Results With the Legally Adopted Budget

The budget document is considered by most to be the primary source of governmental information. The three user groups previously identified (citizenry, legislative and oversight bodies, and investors and creditors) are generally interested in comparing originally adopted budgets and budgets after final amendments, with the actual results of the current year's activities on a budgetary basis. This information may be used to evaluate financial management practices (e.g., spending in excess of budgeted amounts may indicate poor financial management; underspending may indicate that the quality or quantity of services could have been increased, that there was effective cost containment, or that resources were over-budgeted for a particular program).

Form F-195—Official Budget Document

Form F-195 is the official budget document. All school districts must prepare, adopt, and file their budgets in the required format.

For additional information on Form F-195, see Chapter 2—Budgeting.

Form F-198—Budget Status Reports and Statements of Financial Condition

Each school district shall prepare and make available, monthly budget status reports (Form F-198) and other pertinent financial information, as needed by the board of directors.

For additional information on Form F-198, see Chapter 2—Budgeting.

Personnel Budget Status Reports

Each school district shall maintain the capability to prepare monthly personnel budget status reports within ten days when requested by the Office of Superintendent of Public Instruction (OSPI) or the district's board of directors.

For additional information on Personnel Budget Status Reports, see Chapter 2—Budgeting.

FINANCIAL STATEMENTS

Assessing Financial Condition and Results of Operations

Financial reports are commonly used to assess a state or local government's financial condition or its financial position, and its ability to continue to provide services and meet obligations as they come due. In the past, government financial reporting has not emphasized the balance sheet effects of operations because of the viewpoint that current-year costs can be paid with future years' revenues.

However, users have become more interested in government's ability to "live within its means." The Governmental Accounting Standards Board (GASB) calls this "interperiod equity." They believe "interperiod equity is a significant part of accountability and is fundamental to public administration. In short, financial reporting should help users assess whether current-year revenues are sufficient to pay for the services provided that year and whether future taxpayers will be required to assume burdens for services previously provided." (GASB Cod. Sec. Appx B-GASB Concepts Statement 1, ¶61.)

Although there is increased interest in the balance sheet, the focal point in governmental financial reports remains the operating statements. The statements provide information on the current financial resource inflows and outflows (for governmental-type activities) and economic resources (for business-type activities). The results of operations can be compared to prior years' results or to other similar governmental entities providing similar services.

Report F-196—Annual Financial Statements

Report F-196 is the required financial statement of a school district. It reports the school district's financial condition and actual revenues and expenditures for the entire school year.

The F-196 (presented on either a cash or modified accrual basis) is used by school districts to comply with the requirements of financial reporting required by OSPI and the State Auditor's Office (SAO), the regulatory agencies. This framework differs from GAAP in several ways and it is considered an other comprehensive basis of accounting (OCBOA). The differences will be discussed later in this chapter.

Overview of Report F-196

The entire Report F-196 is computer-produced by each district's educational service district (ESD). Form SPI/LEA 3011 is used to submit financial data to the ESD. School districts not able to electronically transmit their financial data will have to complete a Form SPI/LEA 3011.

Error edits on Report F-196 must be corrected. Informational messages are also provided. The final Report F-196 cannot be run until all error messages are corrected. The computer-produced error edits and warning messages, including any necessary edit explanations, must accompany the completed Report F-196.

Report F-196—Time Schedule

Failure to adhere to due dates published by OSPI may result in a delay of apportionment (WAC 392-117-035). The final date for filing is considered met if the postmark or other evidence indicates shipment prior to midnight on the final date.

Making Corrections to Report F-196 Annual Financial Statements

The correction procedure consists of the school district filing corrected Report F-196 pages as an "informational supplement." This informational supplement is filed with the district's original Report F-196 at OSPI and the appropriate ESD. A brief memo addressing the pages and accounts, which were changed, should be attached to the corrected pages. The memo should also indicate if the correction was discovered by the district or required by SAO.

Corrected amounts are not updated into computer databases maintained at OSPI. These databases are closed shortly after the end of the fiscal year to facilitate the timely dissemination of annual financial statement data. Revised Report F-196 files provided by the district will not be included in any of the OSPI databases. Therefore, bulletins or financial reports issued by OSPI will not include the revised amounts. Computer edit programs for the School District Official Budget Document (Report F-195) or for Report F-196 will not include the corrected amounts.

The following applies to the filing of corrections:

- The correction must be the correction of an error.
- Corrections can be for any amount no matter how small.
- Only unaudited years are eligible for correction. Years for which an audit has been completed by SAO are not eligible for correction, unless the auditor first agrees to the correction.

Financial Reporting of Corrections

Informational supplements (filings) to Report F-196 are generally only used for making adjustments to reimbursements that result from the correction of errors. They are not a replacement for the accounting and financial reporting of errors that are required in accordance with GAAP.

Since the informational supplement filing does not correct the actual Report F-196 filing, but only supplements it, the district must address the error correction in its current-year financial statements. These error corrections must be done in accordance with Governmental Accounting Standards Board (GASB) Statement 62, which states that immaterial prior period error corrections must be shown in the current-year's revenue and expenditure accounts. If the error corrections are material in amount, the district will need to reflect the changes to the beginning fund balance of the current school year. (See definition of materiality below.) These accounting and reporting steps should be included in Report F-196 for the current year, and **not** for the year in which the error occurred. When the question of a prior period adjustment comes up, the district may wish to work with the SAO's regional audit manager to obtain concurrence on how it should be handled.

Definition of Materiality

Materiality is defined in the FASB's Statement of Financial Accounting Concepts No. 2 as, "the magnitude of an omission or misstatement of account information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."

Governmental Fund Financial Statements

Essentially, the F-196 equates to the governmental fund financial statements. There are two basic governmental fund statements:

- The governmental fund balance sheet
- The governmental fund statement of revenues, expenditures, and changes in fund balances

The F-196 requires the general, associated student body (ASB), capital projects, transportation vehicle, debt service, and permanent funds be reported as major funds.

The Governmental Fund Balance Sheet focuses on current financial resources. Assets should be reported if they are a form of cash or will be converted to cash (e.g., receivables, investments, some capital gifts) or inventories. Assets that are not financial in nature, such as general capital assets (land, buildings and improvements, and equipment) should *not* be reported in governmental funds. Likewise, governmental funds do *not* report unmatured principal and interest of the district's long-term debt. Liabilities such as claims and judgments, compensated absences, and special termination benefits are recognized in the governmental funds only as they become due. Assets and liabilities should be presented in the order of liquidity.

Fund balance is the difference between assets and liabilities. Fund balance is made up of unreserved amounts available for new spending and reserved amounts committed for specific uses. The most common reservations are for long-term loans and advances, legal restrictions, inventories and prepaids, and encumbrances.

Fiduciary Funds—Required Financial Statements

Two statements are required for fiduciary funds (GASB 34, paragraphs 106–109):

- The statement of fiduciary net position
- The statement of changes in fiduciary net position

Separate columns are required for each type of fiduciary fund. Although GAAP discusses four fiduciary types, only two are used by school districts in Washington State. Most districts will have private-purpose trust funds; a few will have pension and other employee benefit trust funds.

The statement of fiduciary net position is reported on the F-196. Fiduciary funds continue to be reported using the economic resources measurement focus and the accrual basis of accounting.

Notes to the Financial Statements

The Notes to the Financial Statements are essential in explaining significant accounting policies and circumstances that affect the district's financial position and results of operations.

Notes in financial reporting are the responsibility of the school district, not the auditor, and accordingly are subject to audit as an integral part of the financial statements. Sample notes to the financial statements are included in the *Administrative Budgeting and Financial Reporting Handbook (ABFR Handbook)*.

The Notes to the Financial Statements are intended to communicate information necessary for a fair presentation of financial position and results of operations that are not readily apparent from, or cannot be included in, the financial statements themselves. The notes are therefore an integral part of the financial statements.

- When preparing Notes to the Financial Statements, delete the notes that do not apply and add others needed for readers to understand the financial statements.
- Example notes presented in the *ABFR Handbook* are considered the minimum requirement for disclosure, as applicable. Since the basis of accounting is other than GAAP, disclosures required for fair presentation include a description of the basis of accounting, how it differs from GAAP and disclosures similar to those required by GAAP for any elements presented in the financial statements that are similar to GAAP. Additional disclosures not specifically shown as examples may also be required to achieve fair presentation for unique facts and circumstances.
- Notes should not include irrelevant, obsolete, trivial or superfluous information. For example, districts should refrain from negative disclosure (stating that a potential disclosure is inapplicable, such as "there were no subsequent events requiring disclosure").
- Note disclosures should be expressed as clearly and simply as possible and include explanations as necessary to ensure it is understandable by users. However, this does not mean that disclosures should avoid precise technical terms or omit or abridge information that may be complicated or difficult to understand.
- The notes to the financial statements can be presented in any format including: narrative; tables; schedules; and matrices, as long as they contain the required information.

FINANCIAL AND SINGLE AUDITS

Financial statement audits provide an audit opinion about whether the district's financial statements are presented fairly in all material respects in conformity with the applicable financial reporting framework. Financial statement audits are performed in accordance with Government Auditing Standards and also include reports on internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, and grant agreements that have a material effect on the financial statements.

Single audits are required if the district spends at least \$750,000 in total federal financial assistance annually. These audits are performed in accordance with Generally Accepted Government Auditing Standards and are an assessment of internal controls over federal programs, tests of how those controls are working, and tests of compliance with federal requirements.

Contact your Local Audit Team at the State Auditor's Office (SAO) to address your questions and discuss your district's audit requirements.

For audit purposes, the financial statement (F-196) is comprised of the following financial elements:

- Balance Sheet
- Statement of Revenues, Expenditures, and Changes in Fund Balance, All Funds—For the Year Ended August 31, 20XX
- Statement of Revenues, Expenditures, and Changes in Fund Balance, Sub Funds of the General Fund—For the Year Ended August 31, 20XX
- Statement of Fiduciary Net Position
- Statement of Changes in Fiduciary Net Position
- Schedule of Long-Term Liabilities

The Schedule of Long-Term Liabilities is required to be included with audited financial statements as supplementary information.

Statements prescribed for the F-196 in *The Accounting Manual for School Districts in the State of Washington* differ from GAAP in the following areas:

- Districtwide statements (Statement of Net Position and Statement of Activities) are not prepared.
- The original adopted budget is not presented. GAAP require this for the General Fund and major special revenue (ASB) fund.

- Infrastructure is not considered material to schools and is not presented.
- Capital assets are not presented in the governmental fund statements, but are disclosed in the notes to the financial statements.
- Long-term debt is reported on a Schedule of Long-Term Liabilities and in the notes to the financial statements, but not in the governmental fund statements.
- The Management Discussion and Analysis, required supplementary information under GAAP, is not required.

SAO's Adverse Opinion on Adherence to U.S. GAAP

SAO has made changes to modified accrual financial statement Audit Reports. This change is effective for the audit reports beginning with the 2016–17 F-196 financial statements.

When providing an opinion on financial statements intended for general use and prepared under a regulatory method of accounting (for example, those in the School District Accounting Manual), United States auditing standards require auditors to express a separate opinion on whether the financial statement presentation was performed in accordance with GAAP.

(Ref: AU-C §800.21)

All financial statement audit reports will contain the following:

- A standard paragraph with an opinion on the fair presentation of the financial statements in accordance with the School District Accounting Manual.
- A separate section stating that the financial statements were not prepared in accordance with generally accepted accounting principles (GAAP) for government organizations (an "adverse" opinion), along with the reason behind the opinion.

In no way does this additional opinion imply the financial statements are unreliable or unfairly presented according to the School District Accounting Manual. Rather, the purpose of the opinion is to let report users know if the financial statement's presentation complies with, or differs from, GAAP.

School district financial statement presentations differ from those required by GAAP as a matter of course. For example, financial statements prescribed by the Accounting Manual do not include full-accrual, government-wide statements. This is a significant departure from GAAP. As a result, auditing standards do not allow the State Auditor to

issue an unmodified, or “clean,” opinion on whether the financial statements conform to GAAP.

SAO issues similar two-opinion reports for local governments, including school districts preparing financial statements on a cash basis. It has even been verified with bond rating and federal regulatory agencies that issuing the modified, or “adverse,” GAAP opinion does not affect bond ratings. In addition, this opinion does not preclude school districts from qualifying as “low risk” for their single audits, as long as all other Uniform Guidance requirements are met.

Basis for Adverse Opinion on U.S. GAAP

Auditing standards issued by the American Institute of Certified Public Accountants (AICPA) require auditors to formally acknowledge when governments do not prepare their financial statements, intended for general use, in accordance with GAAP.

As described in Note 1, management has not presented government-wide financial statements to display the financial position and changes in financial position of its governmental activities. GAAP requires such presentation of government-wide financial statements. The amounts that would be reported in government-wide financial statements for the District’s governmental activities have not been determined. As a result, SAO is required to issue an adverse opinion on whether the financial statements are presented fairly, in all material respects, in accordance with GAAP.

Adverse Opinion on U.S. GAAP

The financial statements referred to above were not intended to, and in our opinion they do not, present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the Example School District No. 999, as of August 31, 20XX, or the changes in financial position or cash flows for the year then ended, due to the significance of the matter discussed in the above “Basis for Adverse Opinion on U.S. GAAP” paragraph.

Internal Control Structure

Professional standards and the Single Audit Act require reports on:

- The internal control structure, based on an audit of the financial statements.
- Single audit report on the internal control structure used in administering federal award programs.

During the audit, a material weakness in the school district's internal control structure may be material errors or material irregularities in the financial statements that would be detected or prevented by the district's internal control structure. When a material weakness is discovered, the standard report form must be modified. The material weakness should be described and the reason for the weakness should be noted. (A material weakness can result from poor internal control design or noncompliance with established controls.)

Reporting Levels of Audit Recommendations

SAO utilizes the following three levels of reporting issues that arise during a financial audit:

- **Findings** formally address issues in an audit report. Districts are given the opportunity to respond to a finding, and this response, or a synopsis of it, will be published in the audit report.
- **Management Letters** communicate less significant issues of noncompliance and make recommendations for strengthening internal controls. Management letters are referenced, but are not included, in the audit report.
- **Exit Items** are less serious audit issues than a finding or management letter. These issues are informally communicated to a district.

OTHER FINANCIAL REPORTS

Assisting Compliance With Applicable Laws, Rules, and Regulations

In addition to the legally mandated budgetary and fund controls, there may be other legal restrictions controlling governmental actions. Financial reports may help demonstrate compliance with grant restrictions, bond covenants, and taxing and debt limits. Failure to comply with legal or contractual provisions may indicate fiscal irresponsibility and could have financial consequences such as disallowed costs, loss of grants, or acceleration of debt payments. Therefore, governments should ensure that the accounting system is capable of providing the necessary information to demonstrate compliance with the applicable laws, rules, and regulations.

Schedule of Expenditure of Federal Awards (SEFA)

A Schedule of Expenditure of Federal Awards (SEFA) must be prepared by all districts that receive federal funds. It is required to be included as supplementary information with the audited financial statements.

OMB Uniform Audit Requirements §200.510(b) prescribes the form and content of the SEFA, which is used by auditors to determine if a single audit is required and to help identify which federal programs will be audited. Refer to the Accounting, Budgeting, and Financial Reporting Handbook, Chapter 11, for more information on the SEFA.

Assisting in Evaluating Efficiency and Effectiveness

Taxpayers and other governmental entities want information about service efforts, costs, and accomplishments of governmental entities and consider this information a necessary element of financial reporting. This information, along with additional information, may help users assess the economy, efficiency, and effectiveness of a government and may help form a basis for voting or funding decisions. To be of value, the information needs to be of sufficient detail to permit comparisons with other years and other governmental entities.

Currently, in the state of Washington, there are no required reports of this kind, although some districts may already be issuing this type of report for the board and the taxpayers of the district. They may provide reports on the cost of providing education to students at different grade levels over a period of time, or the cost of housing students now, as compared to projections for the future.

Schedule of Long-Term Liabilities

This schedule provides information about the outstanding liabilities of a school district. It is used to corroborate information on various amounts of liabilities that are shown on the district's balance sheets, as well as information on long-term liabilities that are not displayed on the balance sheets. Non-bond debt, such as notes, leases, lines of credit and the like are reported in the fund that issued the debt or recorded the liability. Bonded debt, whether voted or non-voted, is reported in the Debt Service Fund.

Instructions

The only amounts that should be reported on the Schedule of Liabilities are the principal amounts that are outstanding on the individual items. Interest is not

reported on the Schedule of Liabilities. Amounts that should be excluded from this schedule are payments due to vendors or employees that are expected to be paid normally as part of the disbursement cycle (i.e., accounts payable, payroll accruals), interfund loans (they do not represent a net claim on the financial resources of the district) and regular operating leases (except non-cancelable operating leases).

For each type of liability, record the appropriate amounts in each of the five columns.

- Column 1: Beginning Balance: Record the balance for the liability as of September 1 of a given reporting year. This should match the amount reported August 31 of the prior year.
- Column 2: Amount Issued or Increased: Record the amount of new debt or liabilities that were issued during the year. In instances of bond or other debt refunding, the new issue should be recorded in this column.
- Column 3: Amount Redeemed or Decreased: Record the amount of debt or liabilities that were liquidated during the year. In instances of bond or other debt refundings, the principal amount that has been refunded should be recorded in this column. Only record the amount of principal that has been paid during the year; do not include any interest payments.
- Column 4: Ending Balance: The ending principal balance for the various liabilities as of August 31 of a given reporting year. This should equal Beginning Balance plus Amount Issued or Increased minus Amount Redeemed or Decreased.
- Column 5: Amount Due Within One Year: Record the principal amount outstanding at the end of the year that will become due by August 31 of the subsequent year. Amounts that should be excluded from this schedule are payments due to vendors or employees that are expected to be paid normally as part of the disbursement cycle with current available resources.

If a district has a line of credit with their county treasurer or another financial institution, only the amount that has actually been used is to be reported on the Schedule of Liabilities. Any unused portion of the line of credit will need to be reported in the Notes to the Financial Statements.

In addition, districts will need to disclose information about these long-term liabilities in the Notes to the Financial Statements.

(Sample School District)
 Schedule of Long-Term Liabilities
 For the Year Ended August 31, 20XX

Description	Beginning Balance	Amount Issued or Increased	Amount Redeemed or Decreased	Ending Balance	Amount Due Within One Year
Voted Debt					
Voted Bonds					
LOCAL Program Proceeds Issued in lieu of bonds					
Non-Voted Debt and Liabilities					
Non-Voted Bonds					
LOCAL Program Proceeds					
Capital Leases					
Contracts Payable					
Claims & Judgments					
Non-Cancellable Operating Leases					
Compensated Absences					
Long-Term Notes					
Anticipation Notes Payable					
Lines of Credit					
Other Non-Voted Debt					
Other Liabilities					
Net Pension Liability TRS 1					XXXXXXXXXX
Net Pension Liability TRS 2-3					XXXXXXXXXX
Net Pension Liability SERS 2-3					XXXXXXXXXX
Net Pension Liability PERS 1					XXXXXXXXXX

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