




How to Read Government Financial Statements - Exercises

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Each item below represents a problem encountered in an audit.

For each item: Identify

- The type of problem: GAAP departure or Scope limitation.
- The type of audit opinion that might result: Unmodified, modified, adverse, disclaimer
- The financial statement opinion affected: Governmental activities, aggregated discretely presented component units, major fund, aggregate remaining fund information.

Exercise #1: Audit problems

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<i>Audit problem</i>	<i>Type of problem</i>	<i>Type of audit opinion</i>	<i>FS opinion affected</i>
The component unit's column does not include the financial statements of the Healthcare Corporation.	GAAP departure	Qualified or adverse	Aggregate discretely presented component units

Exercise #1 -1

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<i>Audit problem</i>	<i>Type of problem</i>	<i>Type of audit opinion</i>	<i>FS opinion affected</i>
Management has not adopted GASB Statement No. 68, Accounting and Financial Reporting for Pensions. The government has not recorded pension expense, related net pension asset or liability, deferred outflows of resources, and deferred inflows of resources.	GAAP departure	Qualified or adverse	Governmental activities

Exercise #1 -2

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<i>Audit problem</i>	<i>Type of problem</i>	<i>Type of audit opinion</i>	<i>FS opinion affected</i>
The Government has not recorded a liability for land leases and related claims payable in the governmental activities and the General Fund and has not recorded the current period expense.	GAAP departure	Qualified or adverse	Governmental activities General Fund (major fund)

Exercise #1 -3

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<i>Audit problem</i>	<i>Type of problem</i>	<i>Type of audit opinion</i>	<i>FS opinion affected</i>
The financial statements do not include financial data for the Fishing Authority, a component unit.	GAAP departure	Qualified or adverse	Aggregate discretely presented component units

Exercise #1 -4

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<i>Audit problem</i>	<i>Type of problem</i>	<i>Type of audit opinion</i>	<i>FS opinion affected</i>
The financial statements for the Technology Park have not been audited. The Park's financial activities have been included in the basic financial statements as discretely presented component units.	Scope limitation	Qualified or disclaimer	Aggregate discretely presented component units

Exercise #1 -5

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<i>Audit problem</i>	<i>Type of problem</i>	<i>Type of audit opinion</i>	<i>FS opinion affected</i>
The Government's aggregate remaining financial information does not include the financial statements of the Settlement Fund, a fiduciary fund component unit.	GAAP departure	Qualified or adverse	Aggregate remaining fund information

Exercise #1 -6

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Each item below represents an internal control or compliance problem encountered in a Single Audit.

For each item: Identify

- The type of problem: Internal Control over Financial Reporting (ICFR) or Compliance (C).
- How to fix the problem
- How long it will take to fix the problem
- Whose responsibility it is to fix the problem

Exercise #2: Internal Control and Compliance Findings

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Criteria & Condition: The Government's operations are complex and many accounts require management estimation and judgment. GAAP requires that management analyze and assess the reasonableness of such accounts on a recurring basis. Multiple audit adjustments were required to correct errors in these accounts. One example is the compensated absences liability account which is not being properly tracked and adjusted.

Problem #1: Management Estimates

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Cause: There are no formal policies or procedures in place to analytically review each management estimate account, or to assess large, unusual transactions.

Effect: The Government's financial statements are not fairly presented on a monthly or interim basis.

Problem #1: Management Estimates 70

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Recommendation: We recommend that policies and procedures governing management estimate accounts be formally documented. There should be a robust analysis and detailed support for each calculation and transaction. This function should be performed by a senior accountant or appropriate departmental staff person with review and oversight by a qualified individual. Certain accounts may lend themselves to quarterly or even monthly review.

Problem #1: Management Estimates 71

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- Allowance for bad debts
- Compensated absences payable
- Pension-related expense and liability
- Claims payable
- Deferred inflows and outflows

Common Estimates in FS

NEW

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Type of problem: ICFR

How to fix it:

Develop policies and procedures over management estimate accounts.

- Identification of the accounts
- Preparation of estimates, including how often
- Review of estimates
- Time frame

Review and approval of policies and procedure

Implementation of policies and procedures

Follow-up monitoring

Supervisor verification of timely completion

Problem #1: Management Estimates 72

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How long it will take: 3-6 months?

Whose responsibility is it?

Accountants and supervisors

Director of Finance

To clear audit finding:

- Provide copies of approved policies & procedures to auditors
- Include sample from monitoring to show that P&P have been implemented and are working properly

Problem #1: Management Estimates 73

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Criteria & Condition: Procurement transactions are required to be conducted in a manner providing full and open competition. Price quotations sent to vendors included requirements for a particular brand name, product, or feature of a product, peculiar to one manufacturer, thereby precluding consideration of an equivalent product manufactured by another company.

Problem #2: Procurement 74

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- Cause: The Government is not consistent in applying applicable procurement requirements.
- Effect: The Government is in potential noncompliance with procurement regulations and questioned costs of \$75,000 have resulted.
- Recommendation: The Government should follow and document full and open competition procedures in accordance with applicable procurement regulations.

Problem #2: Procurement

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Type of problem: Compliance

How to fix it:

Investigation – why did this happen?

Training on procurement regulations and requirements

How long it will take: 1-3 months?

Problem #2: Procurement

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Whose responsibility is it?

Finance, Procurement, Departments

Head of Procurement

To clear audit finding:

Prepare brief write-up summarizing training held including dates, attendees, content

To clear questioned costs:

Request and obtain approval from grantor agency

Problem #2: Procurement**77**

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Criteria & Condition: Accrued leave is limited to 45 days or 360 hours. Accrued annual leave for separated employees should be identified and reviewed for validity. As of year-end, compensated balances payable included \$100,000 of accrued leave for inactive, terminated, resigned, or retired employees. The balance also included \$755,000 accrued leave in excess of the 45-day/360-hour limit. Individual debit balances of \$100,000 were also present.

Problem #3: Compensated Absences 78

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Cause: The Government lacks adequate procedures and controls to determine that accrued annual leave is reviewed for validity and lacks timely updates of payroll records.

Effect: Compensated absences payable and related expenditures could be misstated.

Recommendation: Responsible personnel should record valid charges as compensated absences payable.

Problem #3: Compensated Absences 79

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(7) Changes in Long-Term Liabilities

\$21,510,948

Other long-term liabilities will generally be liquidated in the future from the General Fund. During the year ended September 30, 2018, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net position:

	Balance October 1, 2017 (As Restated)	Additions	Reductions	Balance September 30, 2018	Due Within One Year
GO Bonds payable:					
General obligation bonds	\$ 15,230,000	\$ -	\$ (4,785,000)	\$ 10,445,000	\$ 5,070,000
Discount on bonds issued	(357,979)	-	116,102	(241,877)	-
	<u>14,872,021</u>	<u>-</u>	<u>(4,668,898)</u>	<u>10,203,123</u>	<u>5,070,000</u>
LO Bonds payable:					
Limited obligation bonds	1,071,165,000	-	(19,125,000)	1,053,040,000	21,510,000
Premium on bonds issued	96,836,453	-	(4,309,852)	92,446,571	-
Discount on bonds issued	(1,685,218)	-	73,006	(1,612,212)	-
	<u>1,166,316,235</u>	<u>-</u>	<u>(22,441,876)</u>	<u>1,143,874,359</u>	<u>21,510,000</u>
Loans payable	10,357,318	-	(773,374)	9,583,944	5,795,169
Other long-term liabilities:					
Compensated absences	26,116,303	6,277,554	(10,882,999)	21,510,948	7,319,970
Capital lease obligations	200,062,016	-	(7,974,147)	192,087,869	8,255,215
DCRS sick leave liability	34,718,763	924,145	(18,432,642)	17,210,266	-
Net pension liability	1,117,803,682	21,995,903	(134,628,104)	1,005,171,481	-
OPFS liability	1,731,236,159	-	(61,412,135)	1,669,824,024	-
Tax credits payable	4,826,124	-	(1,187,023)	3,639,101	3,639,101
Due to IRS	19,937,926	-	-	19,937,926	19,937,926
Landfill closure	16,186,087	3,825,999	-	20,012,086	-
	<u>3,150,937,050</u>	<u>33,023,601</u>	<u>(234,516,960)</u>	<u>2,949,443,701</u>	<u>39,152,212</u>
	<u>\$ 4,342,482,634</u>	<u>\$ 33,023,601</u>	<u>\$ (262,401,108)</u>	<u>\$ 4,113,105,127</u>	<u>\$ 71,527,401</u>

GovGuam – Compensated Absences Liability

NEW

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Type of problem: ICFR

How to fix it:

Assign accountant to clean up account

Develop procedures for investigating and resolving accrued leave for

- Separated employees
- Balances in excess of 45-day/360 limit
- Debit balances

Develop procedures to ensure necessary information received by accountant

- Notification of separated employees
- Updates for leave taken

Approve and implement procedures

Follow-up monitoring

**Robotic process automation
RPA**

Problem #3: Compensated Absences 80

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How long it will take: 3 to 6 months

Whose responsibility is it?

Payroll

Director of Finance

To clear audit finding:

- Provide copies of approved policies & procedures to auditors
- Include sample from monitoring to show that P&P have been implemented and are working properly

Problem #3: Compensated Absences 81

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Assume that you are the loan officer for the Pacific Region Development Bank. The Island Government is seeking a \$5 million, 20-year loan to construct a new administrative center.

The audited financial statements for Island Government provide the following information:

Exercise #3: Loan Approval

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From the *Statement of Activities*:

Revenues from taxes and fees	\$3,800,000
Revenues from other sources	<u>200,000</u>
Total revenues	\$4,000,000
Total expenditures	<u>4,000,000</u>
Net (expenses) revenues	<u>\$ -0-</u>

Exercise #3: Loan Approval

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From the *Statement of Net Position*:

Cash and investments (at market value)	\$ 800,000
Capital assets, net	<u>4,200,000</u>
Total assets	<u>\$5,000,000</u>
Total liabilities	500,000
Total net position	<u>\$4,500,000</u>
Total liabilities and net position	<u>\$5,000,000</u>

Exercise #3: Loan Approval

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1. What information in the financial statements is relevant to your decision?
2. Is there other information that you would like to review before making the decision?
3. Will you approve the loan? Why or why not?

Exercise #3: Loan Approval

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- Whether Net (Expenses) Revenues is a positive number
 - How large is the number?
 - Is the government easily covering its expenses?
- Amount of cash on hand
 - Is cash sufficient to make loan payments?
- Other assets available
 - Investments (at market value)

#1: What information in the financial statements is relevant to your decision? 120

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- Are other sources of revenue available?
- How old are the assets? Will they need to be replaced soon?
- Will the government be able to provide the increased operating expenses for the new center? How?

#2: Is there other information that you would like to review before making the decision? 121

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- Based on info provided, no.
- Island Government won't be able to make loan payments
- Also doesn't appear to be able to cover higher operating costs of new center
- No other assets/resources available to help make the loan payments

#3: Will you approve the loan? Why or why not?

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An adjusted trial balance has been prepared for the Island Government General Fund as of 9/30/19. Use the balances provided to prepare the financial statements for the General Fund. Prepare the Statement of Revenues, Expenditures, and Changes in Fund Balance first. Then prepare the Balance Sheet.

Exercise #4: Financial Statements

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- Which accounts go into the Statement of Revenues, Expenditures, and Changes in Fund Balance?
- Which accounts go into the Balance Sheet?

Which accounts go where?

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Assets
100-130

Liabilities
200-240

Fund Balance
300-310

Other Sources
490, 590

#	Account Name	DR	CR
100	Cash	460,000	
110	Accounts Receivable	194,400	
111	Allowance for Doubtful Accounts		18,000
115	Travel Advances Receivable	18,000	
117	Advances to Vendors	3,400	
130	Due From Other Funds	1,000	
200	Accounts Payable		76,000
205	Salaries Payable		4,500
210	Withholding Taxes Payable		450
220	Social Security Taxes Payable		270
230	Allotments Payable		1,200
240	Due to Other Funds		500
300	Fund Balance - Unassigned		82,420
310	Fund Balance - Assigned		5,000
400	Compact Revenues		1,320,000
410	Import Tax Revenues		120,500
420	Withholding Tax Revenues		38,600
430	Fuel Excise Tax Revenues		54,000
440	Interest Income		1,100
490	Operating Transfers (In)		15,300
510	Salaries Expenditures	652,300	
515	Employer Tax Contributions Exp.	38,140	
520	Materials & Supplies Expenditures	56,700	
530	Travel Expenditures	32,100	
535	Equipment Expenditures	129,500	
540	Utilities Expenditures	157,300	
550	Telephone Expenditures	34,200	
570	Bad Debt Expenditures	3,000	
580	Misc. Expenditures	2,000	
590	Operating Transfers (Out)	14,300	
	TOTAL	1,797,840	1,797,840

Revenues
400-440

Expenditures
510-580

Adjusted Trial Balance

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**GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE
For year ending September 30, 2019**

REVENUES

Compact Revenues	1,320,000
Import Tax Revenues	120,500
Withholding Tax Revenues	98,600
Fuel Excise Tax Revenues	54,000
Interest Income	<u>1,100</u>
Total Revenues	<u>1,594,200</u>

**Statement of Revenues, Expenditures, &
Changes in Fund Balance**

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EXPENDITURES

Salaries	652,300
Employer Tax Contributions	39,140
Materials and Supplies	56,700
Travel	32,100
Equipment	129,500
Utilities	157,800
Telephone	34,200
Bad Debts	3,000
Miscellaneous	<u>2,000</u>
Total Expenditures	<u>1,106,740</u>

**Statement of Revenues, Expenditures, &
Changes in Fund Balance**

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EXCESS (DEFICIT) OF REVENUE OVER EXPENDITURES	487,460
OTHER SOURCES (USES)	
Operating Transfers (In)	15,300
Operating Transfers (Out)	<u>(14,300)</u>
NET CHANGE IN FUND BALANCE	488,460
FUND BALANCE, BEG. OF YEAR	<u>87,420</u>
FUND BALANCE, END OF YEAR	<u>575,880</u>

Statement of Revenues, Expenditures, & Changes in Fund Balance

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Beginning FB Unassigned	82,420
Net Change in FB	<u>488,460</u>
Ending FB Unassigned	<u>570,880</u>

Fund Balance Unassigned

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**GENERAL FUND
BALANCE SHEET
September 30, 2019**

ASSETS

Cash	460,000
Accounts Receivable, net of allowance	176,400
Travel Advances Receivable	18,000
Advances to Vendors	3,400
Due from Other Funds	<u>1,000</u>
Total Assets	<u>658,800</u>

Balance Sheet

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LIABILITIES

Accounts Payable	76,000
Salaries Payable	4,500
Social Security & Withholding	
Taxes Payable	720
Allotments Payable	1,200
Due to Other Funds	<u>500</u>
Total Liabilities	<u>82,920</u>

Balance Sheet

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FUND BALANCE

Fund Balance – Assigned	5,000
Fund Balance – Unassigned	<u>570,880</u>
Total Fund Balance	<u>575,880</u>
Total Liabilities and Fund Balance	<u>658,800</u>

Balance Sheet

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