

**Manual of Accounting and Financial Reporting for
Pennsylvania Public Schools**

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**** Updated 5/1/05 ****

Financial reporting plays a critical role in the process of holding both governments and government officials accountable to their constituencies. Financial reporting that allows for the attainment of such accountability enables the user of that information to confidently make decisions regarding the suitability of officials for continued public service, the purchase of a government's debt instruments and other issues.

The focus of governmental accounting is on the collection and analysis of data related to a government's finances. There is little value, however, in financial data that are not conveyed to end users in a manner that imparts value and relevance. Accordingly, financial reporting serves as a critical link between the accounting systems maintained by government institutions and the public served by those governments.

This Chapter will examine issues related to the proper financial reporting of accounting data related to public school entities. It will also present several avenues through which school business personnel may be recognized for excellence in meeting the goal of public accountability through financial reporting.

Topics of discussion will include:

- ❖ Financial Reporting Objectives;
- ❖ The Financial Reporting Pyramid;
- ❖ Reporting Requirements;
- ❖ The Financial Reporting Entity;
- ❖ Basic Financial Statements;
- ❖ Notes To Be Included With The Statements;
- ❖ Supplemental Statements To The Annual Financial Report;
- ❖ The Comprehensive Annual Financial Report;
- ❖ Awards For Financial Reporting Excellence; and
- ❖ Popular Reports

Financial Reporting Objectives

The GASB Concepts Statement No. 1 sets forth six characteristics which accounting data must possess in order to be considered of value to users. These characteristics are briefly summarized as follows:

❖ ***Understandability***

Information should be presented as simply as possible. To be publicly accountable, a government should issue financial reports that can be understood by those that may not have a detailed knowledge of accounting principles. Reports should include explanations and interpretations that help users understand the information provided. (GASBCS 1, 62)

❖ ***Reliability***

The information presented should be verifiable and free from bias and should faithfully represent what it purports to represent. Information must be comprehensible and should not be misleading. Reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured. A properly explained estimate provides more meaningful information than no estimate at all. (GASBCS 1, 63)

❖ ***Relevance***

Relevance encompasses many of the objectives of financial reporting. For example, if the information provided in a financial report is not timely or reliable, it is not relevant. Information can, however, meet all other objectives and still not be relevant. To be relevant, there must be a close logical relationship between the information provided and the purpose for which it is needed. Information is relevant if it is capable of making a difference in a user's assessment of a problem, condition or event.

❖ ***Timeliness***

To optimize value to users, financial reports must be issued promptly after the close of the related accounting cycle. Clearly, financial reports issued one (1) month after the close of the accounting cycle will be much more valuable to users than reports issued twelve months after the close of the same accounting period.

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❖ Consistency

Financial reports should be consistent over time; that is, there is a presumption that once an accounting principle or reporting method is adopted, it will be used for all similar transactions and events. This concept extends to areas such as valuation methods, basis of accounting and determination of the financial reporting entity. If accounting principles or methods have changed or if the financial reporting entity has changed, the nature and reason for the change as well as the effect of the change should be disclosed. (GASBCS 1, 67)

❖ Comparability

Financial reports should be comparable. This does not imply that all schools perform the same functions. Comparability implies that differences between financial reports should be due to substantive differences in the underlying transactions or the governmental structure rather than due to selection of different alternatives for accounting procedures and practices. (GASBCS 1, 68)

Required Types Of Financial Reporting For Pennsylvania Public School Entities

❖ Types Of Reporting

Accounting data are communicated to users both inside and outside the government. Internal reporting is designed to meet the needs of the LEA's management and School Board. External reporting may be either specific or general; it may be specifically directed at users such as grantors, or supplied with the intent that those who use it do so with a more general interest in governmental finances.

INTERIM REPORTS

Interim financial reports are prepared primarily for the use of management or for governmental oversight. It is rare that these reports will be issued to the general public. These are reports prepared on a monthly or quarterly basis that show financial position, operating results, and other pertinent information. These reports may also be utilized to compare budget to actual financial data. The key criteria by which the interim financial reports are evaluated are relevance and usefulness for management control and planning. Examples of interim reports that are required under legislation are displayed below:

<u>School Code Reference</u>	<u>Report</u>	<u>Frequency</u>
Section 440	Treasurer's Report	Monthly
Section 504	Statement of Cafeteria Fund Operations	Monthly
Section 511	Statement of Student Activity Funds	Monthly or Quarterly
Section 607	Listing of Bills Payable	Monthly
Section 624	Reports by Depositories (Bank Reconciliations)	Monthly
Section 660	Report of Taxes Collected (1 st Class Districts)	Monthly
Section 2133	Budget to Actual Comparison (1 st Class Districts)	Quarterly

ANNUAL REPORTS

LEAs must also comply with requirements to report financial information on an annual, fiscal year basis. These documents are made available to the public as a matter of course and are also scrutinized by governmental oversight agencies. The required annual financial reports and relevant school code references are presented below:

<u>School Code Reference</u>	<u>Report</u>
Section 216	Report of Investment Accounts and Gifts to the District
Section 633	Statement of Indebtedness (Part of Annual Financial Report)
Sections 664 & 687	Comprehensive Budget
Section 971	IU Financial Report
Section 2408	School District Annual Financial Report

Two (2) of these annual reports are of particular relevance to all LEA's in the Commonwealth and will be discussed in greater detail here. Those reports are the General Fund Budget and the Annual Financial Report.

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Annual LEA Budgets

Budgeting is an essential element of the financial planning, control, and evaluation process in school entities and other governmental units. Budgeting is the primary tool available to school boards and administrators for the purposes of both planning the financial direction that the district will take and implementing controls that will ensure that direction.

Every school district should prepare comprehensive annual budgets for all governmental, proprietary, and fiduciary funds. However, the requirements of the Pennsylvania School Code of 1949 extend only to the preparation of General Fund Budgets. The Pennsylvania Department of Education suggests that school districts employ both General and Special Revenue Fund budgets because of the essential nature of these funds. Special Revenue Funds include Capital Reserve Funds and Athletic Funds. Federal funding is not included in special revenue funds because federal funds must be included in the school's General Fund Budget and AFR to obtain a restricted indirect cost rate.

The General Fund Budget should include both the unreserved and reserved fund balances carried forward, revenues to be provided, program allocations by subfunction and major object as well as any reserve for contingency obligations and prior year encumbrances expected to be carried into the new budget year.

Budgetary comparison can be very helpful for financial planning and decision-making. Comparisons between budgeted estimates and actual results are most helpful when done at a program or activity level. Comparisons should be done by function as well as by program. Functions are broad and include: Instruction, Support Services, Non-Instructional, Capital Acquisition and Construction, and Debt Service. Revenue comparisons of budgeted to actual for local, state and federal funding streams should also be done. Revenue trends should also be evaluated when preparing each year's budget. Many schools today use a site-based budget approach, which lends itself to an even more detailed analysis.

It is instructive to make budget comparisons both in terms of dollar amounts and in terms of percentage change from budget period to budget period. Budgetary transfers must be considered when evaluating differences between actual and budgeted amounts.

Several types of budgets are at the disposal of management. Fixed budgets contain estimates of specific (fixed) dollar amounts. This is the type of budget generally employed to create the school's General Fund Budget. Flexible budgeting utilizes dollar estimates that vary according to demand for specific goods or services. This type of budget, when used in combination with a fixed budget, may be useful in managing Cafeteria Fund operations. For example, if demand for school lunches exceeds budgeted expectations during the first few months of the school year, a flexible budget allows for the increased purchase of goods and services related to the greater consumption of lunches. Long-term budgets are budgets that span more than one (1) year. These budgets are used

primarily in planning and controlling capital project revenue and expenditures; primarily building construction and renovation projects.

Budgetary accounting is a management tool used to assist in the control of expenditures and in the enforcement of revenue limits. Budgetary accounting procedures do not affect revenue and expenditure measures, but serve to enforce legal compliance with the Board approved budget limits.

Effective management control and accountability for governmental funds (general, special revenue, debt service, capital projects, and certain trust funds) can best be achieved by using consistent language, a uniform system of account code classification, and interim as well as annual comparative budget to actual financial reports. This goal can be most consistently achieved by utilizing the existing accounting system and reporting formats as the basis for further analysis and decision making.

Pennsylvania law requires that all LEA's, with the exception of intermediate units, prepare and submit to the Department of Education by July 31st an annual budget for their General Fund. Intermediate unit budgets are due by May 1st of each year. Additionally, each LEA must submit a copy of their budget to both the House of Representatives and the Senate. This budget should be prepared on a fund balance to fund balance format and using elements consistent with the basis of accounting utilized by the LEA. Further, it is recommended that each LEA prepare a comprehensive budget for all other funds utilized by management.

Annual Financial Reports

Every public school entity must file an Annual Financial Report (AFR) with the Department of Education's Comptroller's Office each year. The report must be filed on the Pennsylvania Department of Education prescribed form. School districts, area vocational-technical schools, charter schools, and special school reports are due annually on a date specified from the Comptroller. Intermediate unit reports are due annually on October 1st. The AFR is the LEA's representation of its financial position. This is not the school's audit report.

The Annual Financial Report must be completed in accordance with generally accepted accounting and reporting principles for state and local governments and is the LEA management's responsibility. This report must include all funds of the school entity, including any blended component units, and an overview of all discretely presented component units. Component units are other organizations for which the school is financially accountable whose exclusion would cause the school's financial statements to be misleading or incomplete because of the nature and significance of their relationship with the primary school entity.

A school is financially accountable for an organization if the school board appoints a voting majority of that organization's governing body, **and** either has the ability to impose its will on that organization or there is a potential for the organization to be a financial benefit or burden to the school. The school is also financially accountable if that organization is fiscally dependent on the school entity. Please refer to Governmental Accounting Standards Board (GASB) Statement #14 or

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GASB's *Codification of Governmental Accounting and Financial Reporting Standards* Section 2100 for a complete and thorough guide to defining your financial reporting entity.

The Annual Financial Report must include the school's basic financial statements and note disclosures. These are the basic financial statements and notes to the financial statements that are essential to the school's fair presentation of financial position and results of operations, including cash flows of those fund types and component units that use proprietary fund accounting, and required supplemental schedules.

Defining The Financial Reporting Entity

Financial reporting has historically emphasized transactional substance over legal form. That is to say that preparers of financial statements cannot be satisfied with including in their reports only those organizations and activities that are legally defined as being a part of the government being examined. Instead, the preparer of the report must go beyond the legal definition of the entity to include all organizations and activities that may be legally separate but are still a substantive part of the government at hand.

Specific guidelines on defining the financial reporting entity can be found in the GASB's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2100. That guidance will be briefly summarized in the paragraphs that follow.

❖ ***Primary Government***

The core or nucleus of the financial reporting entity is the "primary government." All state governments and general-purpose local governments are considered to be primary governments. In addition, special-purpose governments, which include Pennsylvania public schools, are considered to be primary governments if they meet all of the following criteria:

- ◆ The members of the governing body are chosen in a general election;
- ◆ The government functions as a separate legal entity; and
- ◆ The government is fiscally independent.

A government is considered to function as a separate legal entity if it enjoys the corporate rights typically associated with separate legal status. Examples of such rights include the ability to have its own legal name, the ability to sue or be sued in its own name, and the ability to own property in its own name. If an entity is *not* legally separate, it is considered to be an integral part of whichever government does exercise those powers.

A government is considered fiscally independent when it is not subject to outside interference with regard to such matters as creating a budget, setting taxes and fees, or issuing bonded debt. Broadly imposed limitations, such as a prohibition of all school districts of a certain class within a state from issuing bonded debt, or the requirement by state governments that all schools have a balanced budget, do not meet the qualification for disallowance of fiscal independence.

It follows then, that for the purposes of this Manual, only school districts qualify as primary governments under the guidelines identified above. The Commonwealth of PA is not the primary government of any LEA. However, other governmental organizations such as joint ventures, jointly owned organizations, or other stand-alone organizations do form the nucleus of a financial reporting organization and must prepare financial reports. Local Education Agencies (LEAs) that do not meet the definition of a primary government, but which do qualify as financial reporting entities and must therefore issue financial reports include area vocational technical schools (AVTSS), charter and special schools and intermediate units.

COMPONENT UNITS

The financial reporting entity includes both the primary government and all of its “component units.” Component units are legally separate entities that meet *any one* of the following three (3) tests:

- Test 1:** The primary government appoints the voting majority of the board of the potential component unit; *and*
- ◆ Is able to impose its will on the potential component unit *and/or*
 - ◆ Is in a relationship of financial benefit or burden with the potential component unit.
- Test 2:** The potential component unit is fiscally dependent upon the primary government; or
- Test 3:** The financial statements would be misleading if data from the potential component unit were not included.

A primary government is said to be “financially accountable” for a component unit if it meets Test 1 or Test 2. Details on all three (3) of these tests are provided below.

It is important to note that an entity can be the component unit of only one (1) primary government. However, situations may arise when a given entity meets the criteria for inclusion as a component unit of more than one (1) primary government. For example, the state could appoint a school board and partially finance its operations (Test 1), while the school board also may be fiscally dependent upon the county (Test 2). Should such a situation arise, a decision must be made to include the school district as a component unit of one (1) or the other primary governments.

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It must be reiterated here that only legally separate entities can properly be defined as “component units.” The conclusion must not be drawn, however, that financial data from entities that are not “legally separate” should be excluded from the financial statements of other governments. Indeed, entities that are not legally separate are automatically included as a part of whatever government exercises legal powers on their behalf.

Test 1: Imposition Of Will / Benefit-Burden Test

The first test of determining whether a potential component unit ought to be included within the financial reporting entity focuses on two (2) issues: 1) the appointment of the potential component unit’s board, *and* 2) the continuing relationship between the primary government and the potential component unit.

Board Appointment: To meet the first test, the primary government must appoint the voting majority of the potential component unit’s governing board. For example, if certain decisions of a potential component unit require a two-thirds vote of a nine-member board, then the primary government must appoint at least six of the board’s nine members.

Continuing Relationship: The appointment of a voting majority of a potential component unit’s board is not, in itself, a sufficient basis for including that unit within the primary government’s financial statements. The Primary Government must also meet one or both of two (2) additional criteria before inclusion of the potential component unit would be appropriate:

- ◆ The primary government has the ability to impose its will on the potential component unit; and / or
- ◆ The primary government enjoys a specific benefit or bears a specific financial burden as a result of its relationship with the potential component unit.

GASB Statement No. 14 provides the following definition of the “Ability to Impose Will:”

- ◆ The Primary Government’s (PG) ability to affect day-to-day operations of a potential Component Unit (CU) is referred to as “ability to impose its will,”
- ◆ A PG has the ability to impose its will if it can significantly influence the potential CU’s programs, projects, activities, or level of services,
- ◆ The PG should be deemed to have the ability to impose its will if it has the ability with respect to the potential CU to:
 - a) remove appointed members of its governing board at will; or
 - b) modify or approve its budget; or
 - c) approve or modify its rate or fee charges; or
 - d) veto, overrule or modify the decisions of its governing body; or
 - e) appoint, hire, reassign or dismiss the managers responsible for day-to-day operations.

Related to the “continuing relationship” criteria outlined above, GASB No. 14 provides the following definition of “Financial Benefit or Burden.”

Financial Benefit

- Legal entitlement to, or ability to otherwise access the resources of an organization.

Financial Burden

- An obligation (legal or otherwise) to provide financial support or to finance deficits of the organization, or
- An obligation in some manner for the debt of an organization.

Test 2: Fiscal Dependency Test

Even though a potential component unit does not meet the requirements described in Test 1, the possibility remains that it should be included in the financial reporting of the primary government. Such an entity would still qualify as a component unit if its fiscal dependence upon the primary government can be established. The criteria for the establishment of the component unit’s fiscal dependence are:

- ◆ The primary government’s approval is needed for the potential component unit’s budget;
- ◆ The primary government’s approval is needed by the potential component unit to set taxes or charges, or
- ◆ The primary government’s approval is needed for the potential component unit to issue bonded debt.

Test 3: Would Omission of Component Unit Be Misleading?

Situations may exist in which the primary government may not be financially responsible for the potential component unit under the parameters of Test 1 and Test 2, but under which it would be misleading for the primary government to exclude the potential component unit from its financial statements. When establishing this test, the GASB was considering the specific case of special financing authorities established for the express purpose of helping financially troubled local governments refinance their debts.

Conclusion

It is clear that charter schools, special schools and intermediate units do not meet the criteria set forth above, and hence, must develop their own financial reports. The case with an AVTS is not as immediately obvious, but upon close scrutiny, the reason for independence is clear. Since it is generally the case that primary governments (school districts) appoint the board of directors that oversee the

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operations of the AVTS, part of the criteria of Test 1 is met. However, because the primary government does not have the direct ability to modify the AVTS budget, does not have direct control over AVTS personnel, and is not legally entitled to the AVTS resources, Test 1 is not met in its entirety. Test 2 is not met because an AVTS is generally dependent on several school districts for support. Further, Test 3 is not met because school districts disclose funds paid to AVTS entities on the annual financial report. There are, however, a few exceptions to this rule; some school districts operate a vo-tech school and have a controlling interest on the Joint Operating Committee.

Financial Statements To Be Included In The Basic Financial Statements (BFS) Section Of The School's Annual Financial Report

In continuing to pursue the concept of establishing “accountability,” we now arrive at the description of the vehicle most effectively utilized to establish that concept with the end user – the Basic Financial Statements (BFS). These general-purpose reports are the minimum acceptable GAAP presentation of the reporting entity. These statements are designed to be “lifted” from the CAFR and included in official statements for bond offerings and for widespread distribution to those users requiring less detailed financial information than is contained in the CAFR. The Basic Financial Statements provide readers with an overview of both the financial position and the results of financial operations for the reporting entity. The governmental unit issuing the BFS should provide an accompanying transmittal letter to inform users of the availability of the CAFR for those requiring more detailed financial information.

Basic Purpose Financial Statements have three components: Government wide financial statements, fund financial statements and Notes to the financial statements.

❖ Government wide financial statements (Statement of Net Assets and Statement of Activities)

Statement of Net Assets

The Statement of Net Assets presents the financial position of the reporting entity on the last day of the fiscal year so LEA statements should be dated June 30, XXXX. The Statement of Net Assets includes the governmental activities and business type activities of the LEA in separate columns. A total column representing the total entity wide activity of the LEA is then presented. Component unit activities are also shown on this Statement but these are not included in the total for the entity wide activities. The Statement of Net Assets uses the economic resources measurement focus and the accrual basis of accounting.

The format for the Statement of Net Assets is to present the assets of the LEA, current and noncurrent, the liabilities also current and noncurrent and finally the net assets of the LEA. The net assets are composed of: Net Assets Invested in Capital Assets, net of related debt; Restricted Net Assets and Unrestricted Net Assets.

Statement of Activities

The Statement of Activities uses the economic resources measurement focus and accrual basis of accounting. The statement provides an accounting of revenues, expenses and other activities that impact on the LEAs net assets.

The purpose of the statement is to provide an accounting of the expenses of the LEA first by governmental fund activity followed by the expenses of the business type activities. These expenses are reflect major functional categories, i.e. Instruction, Instructional support etc. Next are the program revenues that are directly linked to these expenses. There are three types of program revenues: charges for services, operating grants and contributions and capital grants and contributions. A revenue matrix is available on the comptroller's website that provides guidance on the revenues received by LEAs and the appropriate classification of these revenues. The website address is: www.pde.state.pa.us/school_acct Use the link to Accounting Guidance to locate this matrix. Subtracting the program revenues from the corresponding expenses will determine if the program revenues were adequate to cover the expenses or net (expense) revenue.

The next section of the statement provides information on the general revenues and other sources of income used to provide funding not covered by program revenues. Items found here include taxes and basic education funding.

Fund transfers are followed by extraordinary and special items. Extraordinary items are those that are both unusual in nature and infrequent in occurrence. Special items are those that are one or the other and are in the control of the LEA. A transaction that is either unusual or infrequent but is outside the control of the LEA should be disclosed in the notes to the financial statements.

The general revenues and other items are totaled and then added to the net (expense) revenue total derived in the first section of the statement resulting in the change in net assets for the year. This total is then added to the beginning net assets to arrive at the ending net assets for the year. This total must equal the net assets as shown on the statement of net assets entity wide.

❖ **Fund Financial Statements (Governmental)**

The next set of basic financial statements use the current resources measurement focus and modified accrual basis of accounting. The information on these statements is presented according to fund activity. See Chapter 2 of this Manual for a description of the funds available for LEA use. Each fund is evaluated to determine if it meets the criteria to be a major fund or aggregated with other funds and presented in the non-major fund category. Information on determining major fund status is available on the comptroller's website at www.pde.state.pa.us/school_acct Click the link to GASB 34 to access this information.

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Balance Sheet

The balance sheet reports only current assets and current liabilities. Each major fund is presented in a separate column with a separate column for non-major funds. The difference between the assets and liabilities is the fund balance. Fund balance is comprised of two components: reservations and designations. Reservations represent legal obligations of the LEA. Designations represent management's decision to dedicate a portion of the fund balance for future use. A designation is only an intent to spend, this money may be used for another purpose if necessary.

Statement of Revenues, Expenditures and Changes in Fund Balance

This is the operating statement of the LEA. Each major fund is presented in a column with a separate column for aggregated non-major funds. Any fund designated as major on the balance sheet must also be displayed as major on this statement.

Revenues are listed first followed by expenditures. A total line for Excess (deficiency) of revenues over expenditures must be included. Other financing sources (uses) and special and extraordinary items are shown after this line. The Net change in Fund balances is the difference between the Excess (deficiency) of Revenues over Expenditures and the Total Other Financing sources (uses) plus the Special and Extraordinary items. This total is added to the beginning fund balance to arrive at an end of the year fund balance. This total must equal the total ending fund balance on the balance sheet.

Reconciliation Statements

There are two required reconciliation statements. These statements reconcile the information on the fund financial statements that are presented on a modified accrual basis to the entity wide statements presented on full accrual. Some reconciling items include: the impact of acquiring capital assets, long-term liability treatment and revenue recognition.

❖ *Fund Financial Statements (Proprietary funds)*

Statement of Net Assets

This statement is prepared using the economic resources measurement and the accrual basis of accounting. Funds should be presented based on the major fund criteria with a separate column for non-major funds. Internal Service funds are presented on this statement, however they are not included in the major fund criteria and the information is not included in the total column for Proprietary funds.

Assets and liabilities must be displayed as current and non-current. The difference between total assets and total liabilities is the net assets of the fund.

Statement of Revenues, Expenses and Changes in Fund Net Assets

This statement is the basic statement of activities for the proprietary funds and must utilize the same major fund categories as the statement of net assets. The revenues and expenses must distinguish between operating and non-operating.

Combined Statement Of Cash Flows – Proprietary Funds

GASB Statement #9 requires that governmental enterprises prepare a statement of cash flows for each period for which results of operations are reported. This statement is required for all governmental entities that use proprietary fund accounting. Statement #9 requires that the cash flow statement classify cash receipts and payments according to whether they stem from operating, non-capital financing, capital and related financing or investing activities.

The combined statement of cash flows provides the user with information relevant to the cash receipts and cash disbursements of an entity during an accounting period. The statement reports cash receipts, cash disbursements, and net change in cash resulting from operating, investing and financing activities of a governmental entity's proprietary funds. This statement is generally quite useful to the user who has limited knowledge regarding financial matters. Most people, having experience with at least their own checkbook, can relate to issues concerning cash.

When used in conjunction with the statements described above, the statement of cash flows should help clarify issues related to:

- ◆ An entity's ability to generate future net cash flows;
- ◆ An entity's ability to meet its obligations as they come due;
- ◆ An entity's needs for external financing;
- ◆ The reasons for differences between operating income and associated cash receipts and payments; and
- ◆ The effects on the entity's financial position of its cash and non-cash investing, capital and financing transactions during the period.

A statement of cash flows should explain the changes during the reporting period in cash and cash equivalents regardless of whether there are restrictions on their use. The total amounts of cash and cash equivalents at the beginning and end of the period shown in the statement of cash flows should be easily traceable to similarly titled line items or subtotals shown on the Combined Balance Sheet as of those dates.

Cash equivalents are defined as short-term, highly liquid investments that are both:

- ◆ Readily convertible to known amounts of cash; and
- ◆ So near their maturity that they present an insignificant risk of changes in value because of change in interest rates.

Generally, only investments with original maturities of three (3) months or less meet this definition.

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Examples of items commonly considered cash equivalents are Treasury bills, commercial paper, certificates of deposit, money market funds and cash management pools. Cash purchases and sales of these types of investments generally are part of the entity's cash management activities rather than part of its operating, capital, investment and financing activities, and details of those transactions should not be reported in a statement of cash flows.

Not all investments that qualify are required to be treated as cash equivalents. An LEA should establish a policy concerning which short-term, highly liquid investments it will treat as cash equivalents. The LEA should then disclose its policy for determining which of those items are treated as cash equivalents. Any change in that policy is a change in accounting principle and should be reported by restating financial statements for earlier years that are presented for comparative purposes.

GASB Statement #9 recognized two (2) methods for the preparation of cash flows – the "indirect" method and the "direct" method; however, GASB Statement #34 rescinded the indirect method. In the past, many local educational agencies have employed the indirect method to prepare their statement of cash flows. It is important to note here, however, that with the Fiscal Year 1999-2000 Annual Financial Report, only the "direct" method will be permitted with the preparation of this statement.

Notes To Be Included With The LEA's Financial Reports

Notes are an integral part of a governmental entity's external financial reporting and are the LEA management's responsibility. Notes are the means by which the entity amplifies or explains the information presented in the main body of the statements. Information that pertains to specific financial statement items can be explained in qualitative terms, and supplementary data of a quantitative nature can be provided to expand the information in the financial statements. Restrictions placed on the LEA by contractual or financial arrangements are also presented and explained in the notes. Although notes are often written in language that is technical and difficult for the average user to understand, they provide important and meaningful information for the user of financial statements.

The Notes to the Basic Financial Statements should include the following disclosures. Disclosures should be made in the same sequence as listed below:

- I. The Reporting Entity Definition, i.e., The Primary Government, Component Units, Related Organizations And Joint Ventures
- II. Summary Of Significant Accounting Policies (Including departures from GAAP, if any). (Present separately for discrete presentations)
 - A. Criteria Used In Determining The Scope Of The Reporting Entity For Financial Reporting Purposes
 - B. Basis Of Presentation – Fund Accounting
 1. Fund Categories / Generic Fund Types

C. Basis Of Accounting

1. Modified Accrual
2. Accrual

D. Budgetary Data

1. General Budget Policies
2. Encumbrances
3. Budget Basis Of Accounting

E. Assets, Liabilities And Fund Equity

1. Disclosure Of Valuation Bases, Policy For Reporting Infrastructure Assets, And Significant Or Unusual Accounting Treatment For Material Account Balances Or Transactions. These Should Be Described In The Order Of Appearance In The Balance Sheet. Also, Definition Of Cash And Cash Equivalents Used In The Statement Of Cash Flows.

F. Revenues, Expenditures And Expenses

1. Unusual Or Significant Accounting Policy For Material Revenue, Expenditures And Expenses
2. Property Tax Revenue Recognition
3. Vacation, Sick Leave And Other Compensated Absences
4. Grants, Entitlements And Shared Revenues

III. Stewardship, Compliance And Accountability

A. Material Violations Of Finance-Related Legal And Contractual Provisions

B. Deficit Fund Balance Or Retained Earnings Of Individual Funds

C. Excess Of Expenditures Over Appropriations In Individual Funds If Any, Any Explanation Including Remedial Action Planned By Or Required Of The Issuer.

IV. Budget / GAAP Reporting Differences Not Otherwise Reconciled In BFS

V. Detailed Notes On All Funds

A. Assets

1. Cash Deposits And Pooling Of Cash And Investments
2. Investments
 - a) How Is Investment Income Allocated?
 - b) Participation In External Investment Pools
 - c) Show Investments That Are Carried At Amortized Value Instead Of Fair Value
3. Property Taxes

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4. Due From Other Governments – Grants Receivable
5. Joint Ventures
6. Changes In Capital Assets
7. Summary Of Proprietary Fund Assets (Including Construction in Progress)

B. Liabilities

1. Pension Plan Obligations And Postemployment Benefits Other Than Pension Benefits
2. Other Employee Benefits (e.g., Compensated Absence Policy and Other Post Employment Benefits)
3. Construction And Other Significant Commitments
4. Claims And Judgments
5. Lease Obligations (Capital and Operating)
6. Long-Term Debt
 - a) Description Of Individual Bond Issues And Leases Outstanding
 - b) Changes In General Long-Term Debt
 - c) Summary Of Debt Service Requirements To Maturity
 - d) Disclosure Of Legal Debt Margin
 - e) Bonds Authorized But Unissued
 - f) Synopsis Of Revenue Bond Covenants
 - g) Special Assessment Debt And Related Activities
 - h) Debt Extinguishments
 - i) Demand Bonds
 - j) Bond, Tax And Revenue Anticipation Notes
7. Short-Term Debt And Liquidity
8. Obligations Under Reverse Repurchase Agreements
9. Reverse Repurchase Agreements
10. Encumbrances Outstanding

C. Interfund Receivable And Payables And Interfund Eliminations

D. Fund Equity

1. Reservation Of Retained Earnings
2. Reservation Of Fund Balance
3. Unreserved Fund Balance Designations

VI. Segment Information – Enterprise Funds

VII. Related Party Transactions

VIII. Summary Disclosure Of Significant Contingencies

A. Litigation

B. Federally Assisted Programs – Compliance Audits

IX. Significant Effects Of Subsequent Events

Other Supplemental Schedules Required By Commonwealth Reporting Guidelines

The Commonwealth requires that local education agencies include a number of other schedules with their annual financial reports. These schedules will be discussed briefly below:

❖ ***Tuition Schedule***

This schedule is in two (2) parts – tuition earned during the fiscal year and tuition paid to other LEA's during the fiscal year. These schedules are straightforward and self-explanatory. The first part of the schedule contains amounts realized by the LEA for educational services provided to students who reside outside the LEA's boundaries.

Part two of this schedule shows amounts paid by the LEA to other educational agencies, either by direct payment by deduction from the LEAs payments, that have provided educational services to students who reside within the LEA's service area. Such schools may include charter schools and approved private schools, among others.

❖ ***Statement of Indebtedness***

Section I: Principal Amounts Only - All Governmental Fund Types

This section shows all governmental fund indebtedness for which the LEA is obligated. The numbers represent only the principal amounts owed and are divided into short-term borrowing, general obligation bonds, authority building obligations and other long-term debt. Debt at the beginning of the fiscal year is presented, additional debt acquired during the year is added, and debt retired and repaid during the year is subtracted to arrive at the debt outstanding at year-end. GAAP requires this information also, but the Comptroller's Office requires it to meet a USDE reporting requirement.

Section II: Total Principal and Interest Payments – All Funds

This section breaks down the total monies disbursed by the LEA for debt repayment into Principal and Interest columns. Amounts shown here should include debt payments made from all funds and should agree with the debt payments reported for the specific funds throughout the annual financial report.

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❖ **General Fund Encumbrance Schedule**

The Encumbrance Schedule is used to aid the computation of each school's Actual Instructional Expense (AIE). This amount is used in the calculation of Vocational Education subsidies. Completion of this schedule is optional.

The schedule is a listing of all outstanding commitments, by subfunction and object, as of the last day of the fiscal year. Encumbrances are commitments to expend financial resources and are generally executory contracts to be performed at a later date. This executory nature does not permit the inclusion of these funds in the AIE calculation. When these encumbrances are represented on the schedule, the Comptroller's Office is able to determine which encumbrances would have been reimbursable had the contracts been completed by the end of the fiscal year. If identified as such, those amounts are added to expenditures for the computation of the AIE.

❖ **Adjustments Schedule**

The adjustments schedule is an additional part of the annual financial report used to calculate each school's actual instructional expense. This schedule is a listing of all reimbursable expenditures recorded in a Special Revenue Fund or Capital Projects Fund. Expenditures often seen on the adjustment schedule include: improvement of fixed assets, major repairs, and administrative costs associated with such projects. New equipment, building improvements, and transportation expenditures should not be included here. These are expenditures that would be included in the AIE calculation if accounted for in the General Fund.

❖ **Restricted Indirect Costs And Eliminations**

The Restricted Indirect Cost and Eliminations Schedule must be completed in the annual financial report for an LEA to have a restricted indirect cost rate calculated and certified by the Labor, Education and Community Services (LECS) Comptroller's Office. The rate is utilized to recover a portion of indirect costs associated with Federal grants and programs. Indirect costs may not be charged to these programs without a certified indirect cost rate.

The restricted indirect cost and eliminations schedule is designed to collect elements of the indirect cost calculation that are not already available in the annual financial report.

For each of the functions listed on this schedule (2300, 2500 and 2800), report the total amount of allowable costs, if any, and provide a brief explanation of those costs. Simply recording the total expenditures for the function as listed in the detailed section of the AFR is not acceptable.

For each of the function-object combinations listed, report the total amount of expenditures recorded in the general ledger. These expenditures are at a more detailed level than is available in the rest of the AFR, and they are needed to complete the restricted indirect cost rate calculation.

A complete explanation and definition of the Restricted Indirect Cost Rate may be found at www.pde.state.pa.us/state_acct

❖ **Transportation Schedule**

Sections I and II

This schedule is required to accurately calculate an LEA's annual pupil transportation subsidy. All transportation costs for educational field trips and student activities should be charged to the appropriate functional area. However, certain costs are recoverable when calculating the pupil transportation subsidy. Since these expenditures cannot be directly identified from data provided in the AFR, this schedule is included to identify allowable expenditures.

Section III

The cost of renting vehicles for pupil transportation services is used to compute the pupil transportation subsidy. However, these expenditures cannot be identified from the costs as reported in subfunction 2700, object 400 on the AFR. Therefore, this schedule includes a section for reporting these expenditures.

Section IV

Expenditures for the purchase of school buses are included in the computation of the transportation subsidy. Not all purchases are made through the LEA's General Fund. This schedule is designed to collect data related to purchases of school buses made through the Capital Reserve (Special Revenue) Fund.

❖ **Tuition Rate Cost Allocation Schedule**

This schedule collects detailed expenditure data used for computation of both the Elementary and Secondary Tuition Rates. This schedule must be completed by all school districts. The function / object combinations listed here are not available in the detailed General Fund Actual Expenditures and Other Financing Uses Section of the AFR and are necessary to compute LEA tuition rates.

For each function / object combination listed on the schedule, actual expenditures are reported as recorded in the General Ledger. The expenditures reported for object 320 must be equal to or greater than the total of the expenditures reported for objects 322, 323 and 329.

All expenditures must be allocated between the Elementary and Secondary columns, and the sum of Elementary and Secondary expenditures must equal the total.

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Filing Information For The Annual Financial Report

The filing deadline for the Intermediate Unit Annual Financial Report is October 1st.

The filing deadline for all other LEAs is posted on the PDE website for each respective year.

All original AFR paperwork must be submitted to the School Finance Division of the Labor, Education and Community Services Comptroller's Office at:

P.O. Box 60310
Harrisburg, Pennsylvania 17106-0310

Overnight mail must be addressed to:

Labor, Education and Community Services Comptroller's Office
School Finance Division
15th Floor, Labor and Industry Building
7th and Forster Streets
Harrisburg, Pennsylvania 17120

AFR database files must be submitted as email attachments to: schlfin@state.pa.us

Comprehensive Annual Financial Report

Codification Section 2200.101 states that every governmental entity should prepare and publish a Comprehensive Annual Financial Report (CAFR) that encompasses all funds, account groups and component units of the governmental reporting entity. The Codification recognizes the CAFR as the official annual report of the government.

The Basic Financial Statements (BFS), including the basic financial statements and the notes to those statements, and Required Supplementary Information (RSI) are components of a CAFR. The Codification permits the GPFS to be issued separately of the CAFR – for example, in bond offering statements or for widespread distribution to users requiring less detailed information. However, Codification Section 2200.104 states that a transmittal letter from the government that accompanies the GPFS should inform users of the availability of the CAFR.

The following discusses the CAFR's three (3) sections – introductory, financial and statistical.

❖ Introductory Section

The Introductory Section provides general information on a government's structure, personnel, economic situation and finances. It is to include a table of contents, letter of transmittal and other material that management deems appropriate. Generally, other material includes a list of principal officials, an organizational chart, and reproductions of financial reporting awards received on the previous year's CAFR. The transmittal letter

is usually a joint communication from the chief financial officer and the chief executive officer that is addressed to the government's citizens and governing board. Although the Codification does not include specific standards for the contents of the transmittal letter, it generally provides an overview and summary of a government's finances, economic prospects and achievements, including the following discussions:

FORMAL TRANSMITTAL AND MANAGEMENT RESPONSIBILITY - A formal transmittal of the CAFR and management's responsibility for its contents.

FINANCIAL REPORTING ENTITY – The separate legal entities included in the report and the criteria used to include them.

LOCAL ECONOMY – The local economy, including major industries and concentrations, future prospects for the local economy, and the effect of the national, state and regional economies on the local economy.

MAJOR INITIATIVES AND SERVICE EFFORTS AND ACCOMPLISHMENTS – What the government has accomplished and is attempting to accomplish with its resources.

INTERNAL CONTROLS – The objectives of the government's internal control and the limitations in any system of internal control.

BUDGET – The government's budgetary process and the legal level of its budgetary control.

FINANCIAL OVERVIEW – A brief summary of the finances of the general government, including summaries and narrative explanations of revenues by source and expenditures by function. Also, discussions of the government's proprietary and fiduciary activities.

DEBT ADMINISTRATION – Debt outstanding, debt issued and refunded during the year, debt limitations and credit ratings.

CASH MANAGEMENT – The types of investments authorized and held, investment management practices, including investment pooling and collateralization, and investment returns.

RISK FINANCING – The various risks the entity faces and how it finances them.

INDEPENDENT AUDIT – The scope of the audit engagement and the auditing standards used.

AWARDS – Awards received in recognition of the quality of the government's financial management.

ACKNOWLEDGMENTS – Recognition of officials and staff that provided resources and time to the preparation of the CAFR.

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❖ Financial Section

The Financial Section of the CAFR provides financial information on fund types and individual funds and account groups. It starts with the independent auditors' report on the financial statements, which is immediately followed by the BFS and Required Supplemental Information (RSI), as described earlier in this Chapter.

After the RSI, the remainder of the financial section includes a series of subsections presenting individual and combined financial statements and financial schedules. Usually, the cover page for each of these subsections briefly describes the individual funds or account groups in each subsection.

Combining statements of financial position, results of operations, and, if applicable, cash flows are required by fund type when a primary government has more than one (1) fund in a given fund type. When the reporting entity has more than one (1) component unit, combined statements also are required for discretely presented component units, unless those statements are part of the GPFS. Combining statements by fund type for individual component units is also required if information about the underlying fund types of an individual component unit is not available in separately issued financial statements for the component unit. Individual fund and account group statements also should be presented to provide more detailed information than is available in the combined or combining financial statements or if necessary to present prior year comparative data. Financial schedules also are presented within the subsections to:

- ◆ Demonstrate compliance with finance-related legal and contractual provisions;
- ◆ Present information spread throughout the statements that can be brought together and shown in greater detail (for example, taxes receivable, including delinquent taxes, long-term debt; investments; and cash receipts, disbursements and balances); and
- ◆ Present greater detail for information reported in the statements (for example, additional revenue sources detail and object of expenditure data by departments).

❖ Statistical Section

The Statistical Section presents tables of comparative financial data for the past ten (10) fiscal years as well as demographic and miscellaneous data about the government's financial situation. The information in the statistical tables reflects social and economic data, financial trends and the fiscal capacity of the government.

The Codification requires the following statistical tables for the CAFR, but also states that some of these statistical tables may be clearly inapplicable under certain circumstances. For example, a governmental unit with no bonded debt would not need to present the statistical tables related to bonded debt. The Codification also encourages presentation of other appropriate statistical tables that give report users a better historical perspective and assist in assessing current financial status and trends of the governmental unit.

- ◆ General governmental expenditures by function;
- ◆ General governmental revenues by source;
- ◆ Property tax levies and collections;
- ◆ Assessed and estimated actual value of taxable property;
- ◆ Property tax rates – all overlapping governments
- ◆ Special assessment billings and collections if the government is obligated in some manner for related special assessment debt;
- ◆ Ratio of net general bonded debt to assessed value and net bonded debt per capita;
- ◆ Computation of legal debt margin if not presented in the GPFS;
- ◆ Computation of overlapping debt if not presented in the GPFS;
- ◆ Ratio of annual debt service for general bonded debt to total general expenditures;
- ◆ Revenue bond coverage;
- ◆ Demographic statistics;
- ◆ Property value, construction, and bank deposits;
- ◆ Principal taxpayers; and
- ◆ Miscellaneous statistics

For LEAs, such miscellaneous statistics might include, for example, the size and population of the LEA's service area, student enrollment, number of employees, and number and types of schools. Some of this data – such as student enrollment – could be presented for the past ten (10) fiscal years.

Financial Reporting Award Programs

❖ ***Certificate Of Achievement For Excellence In Financial Reporting***

The Government Finance Officers Association (GFOA) conducts an award program called the Certificate of Achievement for Excellence in Financial Reporting Program, which is designed to recognize and encourage excellence in financial reporting by state and local governments, including LEAs. The Association of School Business Officials International (ASBO) conducts a similar program, called the Certificate of Excellence in Financial Reporting, exclusively for LEAs. This program also includes recognition for excellence in budgeting.

These certificate programs encourage governmental entities to prepare and publish an easily readable and understandable CAFR covering all funds and financial transactions of the entity during the fiscal year. An LEA receiving one or both certificates receives not only the awards, but also enhanced credibility for its financial management. The exercise of preparing a CAFR that meets the programs' stringent requirements, which exceed Generally Accepted Accounting Principles (GAAP), brings enhanced discipline to an LEA's financial reporting process and generally improves the resulting financial

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report. Other benefits of the certificate may include improved public relations and acceptance of the school administration's financial goals and objectives, and favorable interest rates when borrowing funds or issuing bonds.

To be eligible for the Excellence in Financial Reporting Certificates, an LEA must publish a CAFR that includes general purpose financial statements presented in conformity with GAAP. The report must be audited in accordance with generally accepted auditing standards and have an unqualified auditors' opinion.

To be eligible for the Excellence in Budgeting Certificate from ASBO, an LEA must publish a Comprehensive Budget Document.

The GFOA and ASBO have different program submission requirements. Both require submission of multiple copies of the CAFR, a completed application form, and a fee. Submissions must be made within six (6) months of fiscal year end. The ASBO program also requires the completion of a self-evaluation checklist. The GFOA program offers participants opportunities for training in program submission requirements.

The GFOA also conducts a Popular Annual Financial Reporting Award Program (PAFR Program). The program is open to governments that have issued a CAFR that received the GFOA Certificate for their most recent fiscal year.

Additional information and application packages for all three (3) award programs can be requested from the GFOA (312) 977-9700 and from the ASBO (703) 478-0405.

❖ *Certificate Of Excellence In Financial Reporting By School Systems*

The Certificate of Excellence in Financial Reporting by School Systems Program is a voluntary program sponsored by the Association of School Business Officials (ASBO) International to foster excellence in the preparation and issuance of school system financial reports. A Certificate of Excellence is awarded to school systems who have submitted their Comprehensive Annual Financial Report (CAFR) for review by an ASBO Panel of Review.

Upon completion of a vigorous technical review, the panel members reach a conclusion regarding whether the school system's CAFR has met the criteria for excellence in financial reporting. The Certificate of Excellence Award is the highest form of recognition in school financial reporting issued by ASBO International.

Initiated in 1972, the program currently receives submissions from approximately 365 school systems and community supported educational institutions in over 30 states. Approximately 325 school systems currently hold Certificates of Excellence. Since Certificates are granted based on a particular fiscal year's report, a school system must resubmit its financial report annually to maintain its Certificate.

❖ **Participation In ASBO's Certificate Of Excellence Program Provides Unique Professional Recognition For School Systems And School Business Officials**

PRESTIGIOUS National Award

The Certificate of Excellence in Financial Reporting is recognized by:

- ◆ Bond Rating Agencies
- ◆ Securities Analysts
- ◆ Underwriters
- ◆ Educational, Teacher and Citizen Groups
- ◆ Accounting Professionals

VALIDATION School System's Fiscal and Financial Management Credibility with its Various Reporting Constituencies

The Certificate of Excellence in Financial Reporting is recognized by:

- ◆ School Board Members, Superintendents And School System Management
- ◆ Educational, Taxpayer And Teacher Organizations
- ◆ Federal And State Granting Agencies

Certification provides a school system's board and superintendent with a measure of the integrity and technical competence of the system's fiscal administration.

ACHIEVE Uniformity in Your School System's CAFR by Using Generally Accepted Accounting Principles

Adherence to the formatting and terminology as promulgated by the appropriate standard setting bodies (GASB, AICPA, etc.) allows for comparisons between:

- ◆ Comparable School Systems
- ◆ School System Reports From Year-To-Year
- ◆ Trend Analysis

ENHANCE Report Presentations

The Certificate of Excellence in Financial Reporting strengthens presentations for:

- ◆ Annual Reports
- ◆ Bond Issuance Official Statements
- ◆ Budget Presentations And Hearings
- ◆ Presentations To The Media

PERSONAL Technical Development

The program stimulates personal technical development through:

- ◆ Completion Of ASBO's Self-Evaluation Worksheet
- ◆ Networking Between Peers, Consultants And CPAs
- ◆ Implementation Of Comprehensive Comments

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PROFESSIONAL Recognition

Recipients of the Certificate of Excellence in Financial Reporting receive:

- ◆ A Plaque And Certificate
- ◆ Comprehensive Comments About Your CAFR From Trained Professionals
- ◆ Recognition In ASBO's Professional Magazine, *School Business Affairs* and newspaper *ASBO Accents*

All LEAs are encouraged to prepare a CAFR and seek one or both of these awards. For additional information on the GFOA and ASBO Awards Programs, see their websites at:

ASBO – www.asbointl.org

GFOA – www.gfoa.org

Popular Reports

While there are no established criteria for popular reports, the following often are cited as guidelines:

- ◆ A popular report should be user-friendly by being short, using a local and easy-to-understand format, using easy-to-read and appealing typography, and using photographs and other artwork to attract reader attention.
- ◆ The report should avoid jargon and technical language, use charts and graphs to convey financial information, and provide information on past trends to give current data a proper context.
- ◆ The report should advise readers of the availability of a CAFR and, if the report contains information only from selected funds, clearly disclose that fact.
- ◆ The report should be distributed so that it meets the needs of its target audience.

Some governmental entities have developed interesting ways of presenting and distributing popular reports. There are popular reports that are published as “town calendars” and as pocket-size “fact books.” Popular reports often are distributed as a tabloid-size insert to local newspapers or distributed to all homes in the jurisdiction through the use of third class “resident” mailings. Popular reports often communicate service efforts (inputs) and accomplishment outcomes.

The Popular Report may also be accompanied by a report from the independent auditor to enhance its credibility. However, this can only be done if the report covers the same financial reporting entity and uses the same measurement focus and basis of accounting as the CAFR.

The GASB has demonstrated the importance of popular reporting by issuing, in 1992, a research report, *Popular Reporting: Local Government Financial Reports to the Citizenry*.

This report summarizes the types of popular reports found in practice, includes a prototype popular report, and suggests the following content for a popular report:

- ◆ Abbreviated operating information;
- ◆ Abbreviated information on financial condition;
- ◆ Situations likely to result in higher taxes or reduced services;
- ◆ Major changes in the private-sector economy affecting local government;
- ◆ Explanation of commitments and expenditures on major capital improvements;
- ◆ Debt position, major changes, and terms of repayment;
- ◆ Explanation of major changes in revenues and expenditures;
- ◆ Explanation of major budget revisions during the year;
- ◆ Revenue and expenditure trend data; and
- ◆ Relevant service efforts and accomplishments.

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