

## CHAPTER 9

# PRINCIPLES OF REPORTING

As was noted in Chapter 3 of this manual, the book entitled "Governmental Accounting Auditing and Financial Reporting (GAAFR)", published by the National Council on Governmental Accounting, describes in detail the principles of reporting in accordance with Generally Accepted Accounting Principles (GAAP). It is the purpose of this chapter to summarize these principles as they apply to Massachusetts municipalities. The reader is referred to GAAFR for a more in-depth treatment of certain issues. In addition to "GAAP reporting" this chapter will provide an overview of the revised "statutory reporting" requirements for Massachusetts municipalities and districts and suggested "interim reporting."

## Background of Reporting in Massachusetts

Cities and towns, as well as other governmental units in the Commonwealth, have prepared and published many different financial and statistical reports at the close of the fiscal year. These reports have included the financial statements of the reporting entity as well as other financial data and statistics. Among the types of financial reports which have been prepared are the following:

**Annual Town or City Report** - presented various financial statements and related data of the municipality and was generally published as a municipal document (Sec 61, Ch 21, MGL).

**Report of Financial Transactions (Schedule A)** - presented municipal receipts and payments in accordance with classifications prescribed by the Director of Accounts and was filed with the Department of Revenue.

**Statement of Indebtedness (Form DA-61)** - presented an analysis of all funded debt, temporary loans and loans authorized and unissued outstanding at the close of the fiscal year. The report was filed with the Department of Revenue..

**Report to the Department of Public Utilities (Form AC-19)** - annual report filed with the Department of Public Utilities by all municipalities operating public utilities.

**End of Year School Return, Pupil and Financial Report** - annual report filed by all school departments and school districts with the State Department of Education.

All of these reports would be classified generally as "statutory" types of reports. A statutory report, then, is one required by a governing body, whether at the federal, state or local level, to demonstrate compliance with particular sections of the law, or to obtain data necessary for a particular government function. It should not be inferred that these reports were used solely by other intergovernmental units. On the contrary, these reports were generally utilized by other so-called users of financial data, including the investing community, the taxpayers, a municipality's governing body, creditors and others. They were often the only financial reports that most communities prepared and published.

In 1976, a change in the form and content of financial reporting by Massachusetts municipalities began to take place. Perhaps the principal catalyst for change was the 1976 Amendments to the Revenue Sharing Act, which for the first time imposed audit requirements on most recipients. However, in the view of most observers, this development was simply one of several which resulted from an increasing concern by many during the 1974-1976 period over the condition of municipal finances in general. Other indications of this concern included:

- Formation of the Municipal Securities Rulemaking Board by Congress in 1976 and the implementation of stricter rules relating to municipal bond dealers.
- Publication of recommended disclosure guidelines for state and local governments by the Municipal Finance Officers Association.
- Widespread concern by taxpayers over increasing taxes evidenced by "Proposition 13," the implementation of "tax caps" in Massachusetts, and, most recently, "Proposition 2-1/2."

Massachusetts municipalities have, of course, been affected by these developments. One only has to note the difference in the amount of disclosures made in conjunction with bond offerings in the 1974-1976 period with those being made currently.

Beyond the matter of increased disclosure, however, has been the concern of many for bringing the financial reporting of Massachusetts Municipalities into line with Generally Accepted Accounting Principles (GAAP) as previously explained. With the implementation of the accounting system described in this manual, a significant step will have been taken towards achieving this objective. This type of reporting, then, may be referred to as reporting in accordance with GAAP.

## Reporting and GAAP

The twelfth basic principle of accounting and reporting applicable to governmental units relates to financial reporting and states:

- Appropriate interim financial statements and reports of financial position, operating results, and other pertinent information should be prepared to facilitate management control of financial operations, legislative oversight and, where necessary or desired, for external reporting purposes.
- A comprehensive annual financial report covering all funds and account groups of the governmental unit (including appropriate combined, combining, and individual fund statements; notes to the financial statements; schedules; narrative explanations; and statistical tables) should be prepared and published.
- General purpose financial statements may be issued separately from the comprehensive annual financial report. Such statements should include the basic financial statements and notes to the financial statements that are essential to fair presentation of financial position and operating results (and changes in financial position of proprietary funds and similar trust funds).

Timely and properly presented financial reports are essential to managers, legislative officials, creditors, financial analysts, the general public and others having need for government financial information. Generally speaking, financial reporting for governmental units includes three types of data presentation:

1. financial statements,
2. schedules, and
3. statistical tables.

These are explained in more detail in Chapter 11, Comprehensive Annual Financial Report.

## **Applicability of Professional Pronouncements to Financial Statements**

As has been noted earlier, in Chapter 1 (page 6), the body of knowledge encompassed by the term "generally accepted accounting principles" has, for purposes of governmental accounting and reporting, largely been set forth in GAAFR. There are, in addition to this publication, however, various other pronouncements issued by other authoritative sources of which the reader should be aware. The principal other sources include the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB). In its industry audit guide entitled Audits of State and Local Government Units, published in 1974, the AICPA provided guidance to its members in examining and reporting on financial statements of state and local governmental units.

Included in that publication was a summary of various other professional announcements made by the AICPA through its various committees on accounting and auditing matters, and their relevance to governmental accounting. In order to prepare financial statements in accordance with GAAP, a municipality must comply with those pronouncements of the AICPA and FASB which are relevant to governmental accounting.

It should also be understood that financial statements prepared in accordance with GAAP will always contain adequate footnote disclosure. Both footnote disclosure and applicability of other professional literature to financial statements of government units prepared in accordance with GAAP are described in the above mentioned AICPA audit guide.

## **Reporting Requirements Under UMAS**

A principal objective of the revisions to the State accounting system was to permit Massachusetts municipalities to prepare financial statements on a basis which was closer to GAAP. The implementation of the revised accounting system described in this manual will make the achievement of this objective a fairly simple task. The effect of these revisions on municipal financial reporting will be most evident in the:

Reporting format - due primarily to the incorporation of a multi-fund structure into the revised system, and

Amount of disclosure - where there will be a significant increase and standardization in the amount of information being reported.

All external reporting, whether in conjunction with bond offerings or in connection with year-end statutory reports to the State, will be prepared on the same basis of accounting. Internal reports prepared for the use of municipal management may be prepared on whatever basis will best meet the needs of the management.

The reporting under the revised Uniform System may be logically classified as follows:

**Annual Statutory Reports** - Such reports as those enumerated below will include the specific data needed by the Department of Revenue both for the discharge of its statutory obligations and for input into the "data bank."

**Comprehensive Annual Financial Report (CAFR)** - The CAFR would represent a municipality's official annual financial report for the fiscal year. It would include, in addition to the various financial statements described below, all information and schedules necessary to demonstrate compliance with finance related legal and contractual provisions, and statistical data.

**Interim Management Report** - Interim financial reports would be prepared for the use of internal management and members of the governing board.

Each of these is described briefly in the balance of this chapter. Additional detail, as well as illustrative reports, are contained in the following chapters.

## ***Statutory Reporting***

Although local government units are required to submit a variety of reports to the Commonwealth, the federal government, and others, this manual is concerned primarily with those submitted to the Department of Revenue. Specifically:

- The Annual Financial Report
- Schedule of Debt Authorized and Outstanding
- Quarterly Report of Cash

Standards for these reports are described in Chapter 10.

## ***The Comprehensive Annual Financial Report***

Every governmental unit shall prepare and should publish, as a matter of public record, a Comprehensive Annual Financial Report (CAFR) that encompasses all funds and account groups. The CAFR should contain both (1) the General Purpose Financial Statements (GPFS) by fund type and account group, and (2) combining statements by fund type and individual fund statements. The CAFR is the governmental unit's official annual report and should also contain introductory information, schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, and statistical data.

Governmental units may issue the GPFS separately from the CAFR. These may be issued for inclusion in official statements for bond offerings and for widespread distribution to users requiring less detailed information about the governmental unit's finances than is contained in the CAFR.

The major differences between the GPFS and the other statements in the CAFR relate to the reporting entity focus and the reporting on finance-related legal and contractual provisions that differ from GAAP. The CAFR includes (1) both individual fund and account group data and aggregate data by fund types, together with introductory, supplementary, and statistical information, and (2) schedules essential to demonstrate compliance with finance-related legal and contractual provisions. The GPFS present only aggregate data by fund type and account group, together with notes to the financial statements that are essential to fair presentation, including disclosures of material violations of finance-related legal and contractual provisions and other important matters that are not apparent from the face of the financial statements. Standards for both the CAFR and separately issued GPFS are described in Chapter 11.

### ***Interim Financial Reports***

Interim financial reports are comprised principally of statements that reflect current financial position at the end of a month or quarter and compare actual financial results with budgetary estimates and limitations. Interim reports typically are prepared primarily for internal use. Thus, they often do not include statements reporting general long-term debt. Further, they may properly contain budgetary or cash flow projections and other information deemed pertinent to effective management control during the year.

The key criteria by which internal interim reports are evaluated are their relevance and usefulness for purposes of management control. This includes planning future operations as well as evaluating current financial status and results to date. Although management styles and perceived information needs vary widely, sample interim reports have nonetheless been provided in Chapter 12 for use as a guideline. Whether these or others are used, local management should continually evaluate its interim reports to ensure that this information properly serves management's needs.