PUBLIC HEALTH FINANCE TUTORIAL SERIES
Module V

FINANCIAL REPORTING

MODULE THEME:
TANGELO COUNTY HEALTH DEPARTMENT'S FINANCIAL REPORTS

Tangelo County, which encompasses roughly 875 square miles, has a population of approximately 250,000 spread between a central city (Tangelo City) of roughly 100,000, several smaller communities, and unincorporated rural areas. The public health needs of the county are administered by the Tangelo County Health Department (TCHD). TCHD has 238 full-time employees (FTEs) and an annual budget of roughly $16 million. In the most recent year, TCHD provided clinical services for over 30,000 active clients in the areas of primary medical care (adult and pediatric), dental care, family planning, and specialty care (HIV and STD). In addition to clinical services, TCHD conducts a wide range of programs in disease intervention, environmental health, preventive medicine, and public health preparedness.

TCHD routinely prepares and submits a variety of reports. For example, TCHD's most recent annual report, which is 30 pages long, contains sections devoted to clinical services, disease intervention, environmental health, preventative programs, public health preparedness, and administrative services. The primary purpose of the annual report is to inform the community of the services performed on its behalf. Of course, much of the information contained in the report is useful to TCHD's board, the state health department, and many other groups and individuals that have a stake in TCHD's activities, including its managers.

Although the annual report contains a great deal of information on TCHD's activities, it does not contain much financial data. In other words, it has a lot of numbers in it, but not many dollar signs. However, this does not mean that TCHD, or any other public health organization, has no financial reporting requirements. It has to report financial information to its own board of directors as well as to county and state governments. Such information is vital to ensure proper accountability and oversight. It is in society's best interest that government units, including public health organizations, operate as efficiently as possible. Money is scarce, and it is important to accomplish the greatest good possible from the limited resources available. By the end of this module, you will have a better understanding of government financial reporting at several levels, including TCHD's reporting requirements.

Learning Objectives

After studying this module, you should be able to do the following:

- Describe the historical foundations of financial statements.
- Discuss the key players in financial statement regulation.
- Describe why government and business financial statements differ.
- Explain the format and information contained in the government-wide statement of net assets.
- Explain the format and information contained in the government-wide statement of activities.
- Discuss the key elements of financial reporting by local health departments.

INTRODUCTION

This module contains an overview of how government entities report financial results, with emphasis on financial statements and mandated reporting requirements. *Financial statements* are formal reports of the financial status and activities of businesses and government entities. They carry many names; some that are recognizable such as balance sheet and income statement and others that are not as commonly known such as statement of net assets or statement of activities. Because the format and content of financial statements are specified by external organizations, the financial statements of like organizations are very similar in structure and content.

Although most people think of for-profit businesses when they think of financial statements, many government entities, including the federal government, states, counties, and cities, prepare and distribute financial statements. In addition, many government entities that do not prepare financial statements are required to submit financial data to oversight organizations.

Within the public health community, only a few organizations prepare financial statements. However, those agencies that do not prepare financial statements often have their financial information included in the financial statements of the sponsoring government unit, typically a city, county, or state. In addition, local health departments that are part of centralized state public health systems are required to submit data to state agencies that include much of the information that would be contained in financial statements.

To the uninitiated, financial statements are long, complex documents that only specialists can understand. To a large extent, this is true of the statements prepared by large organizations, whether private or public. Still, the fundamental basis for financial statements as well as their structure is well within the grasp of everyone that has an interest in the financial well being of an organization.

Because financial statements were first developed for private businesses, this module begins with some background information on business financial statements. Then, we explain why government financial statements differ from those prepared by businesses. Finally, we present simple examples of the financial statements of a county as well as the financial reporting requirements of a local health department that is part of a centralized state public health system.

HISTORICAL FOUNDATIONS OF BUSINESS FINANCIAL STATEMENTS

It is all too easy to think of financial statements merely as pieces of paper with numbers written on them, rather than in terms of the economic events and assets—such as land, buildings, and equipment—that underlie the numbers. However, if readers of financial statements understand how and why they began and are used, they can better visualize what is happening within an organization and why financial statements are so important.

Thousands of years ago, individuals and families were self-contained in the sense that they gathered their own food, made their own clothes, and built their own shelters. When specialization began, some individuals or families became good at hunting, others at making spearheads, others at making clothing, and so on. With specialization came trade, initially by bartering one type of goods for another. At first, each producer worked alone, and trade was strictly local. Over time, some people set up production shops that employed workers, simple forms of money were used, and trade expanded beyond the local area. As these simple economies expanded, more formal forms of money developed and a primitive form of banking began, with wealthy merchants lending profits from past dealings to enterprising shop owners and traders who needed money to expand their operations.

When the first loans were made, lenders could physically inspect borrowers' assets and judge the likelihood of repayment. Eventually, though, lending became much more complex. Industrial borrowers were developing large factories, merchants were acquiring fleets of ships and wagons, and loans were being made to finance business activities at distant locations.

At that point, lenders could no longer easily inspect the assets that backed their loans, and they needed a practical way of summarizing the value of those assets. Also, certain loans were made on the basis of a share of the profits of the business, so a uniform, widely accepted method for expressing income was required. In addition, owners required reports to see how effectively their own enterprises were being operated, and governments needed information for use in assessing taxes. For all these reasons, a need arose for financial statements, for accountants to prepare the statements, and for auditors to verify the accuracy of the accountants' work.

The economic systems of industrialized countries have grown enormously since the early days of trade, and hence accounting has become much more complex. However, the original reasons for financial statements still apply: Bankers and other investors need financial information to make intelligent investment decisions; managers need it to operate their organizations efficiently; and taxing authorities need it to assess taxes in an equitable manner. In addition, as we will explain in a later section, the requirement for accountability means that many government entities must also report financial information to their stakeholders in the form of financial statements.

It should be no surprise that problems can arise when translating physical assets and economic events into accounting numbers. Nevertheless, that is what accountants must do when they construct financial statements. Thus, when examining a set of financial statements, it is best to keep in mind the physical reality that underlies the numbers and also to recognize that many problems occur in the translation process.

Self-Test Questions

1. What are the historical foundations of financial statements?

2. Do any problems arise when translating physical assets and economic events into monetary units?

3. Do government entities prepare financial statements? If so, why?

THE USERS OF FINANCIAL INFORMATION

The predominant users of financial information are those parties who have a *financial interest* in the organization and hence are concerned with its economic status. All organizations, whether not-for-profit, investor owned, or government entity have *stakeholders* that have an interest in the organization's well being. For example, in a local public health department, the stakeholders include managers, staff clinicians, other employees, suppliers, creditors, clients, and even the community at large. Because all stakeholders, by definition, have an interest in the organization, all stakeholders have an interest in its financial condition.

Although financial statements and financial reports are designed primarily to meet the information needs of outside parties, the managers of an organization, including its board of directors (trustees), also are important users of the information. After all, managers are charged with ensuring that the organization has the financial capability to accomplish its mission, whether that mission is to maximize the wealth of its owners or to provide healthcare services to the community at large. Thus, an organization's managers are not only involved with creating financial statements and reports, they are also important users of the information, both to assess the current financial condition of the organization and to formulate plans to ensure that the future financial condition of the organization will support its goals.

Self-Test Question

1. Who are the primary users of financial statements?

2. Are financial statements and reports used by managers in addition to outside parties? If so, in what way?

FINANCIAL STATEMENT REGULATION AND STANDARDS

As a consequence of the Great Depression of the 1930s, which caused many businesses to fail and almost brought down the entire securities industry, the federal government began regulating the form and disclosure of information related to businesses with publicly traded securities. The regulation is based on the theory that financial information constructed and presented according to standardized rules allows users of that information to make the best-informed decisions. The newly formed *Securities and Exchange Commission (SEC)*, an independent regulatory agency of the U.S. government, was given the authority to establish and enforce the form and content of financial statements.

Rather than directly manage the process, the SEC designates other organizations to create and implement the standard system. For the most part, the SEC has delegated the responsibility for establishing standards for businesses to the *Financial Accounting Standards Board (FASB)*—a non-governmental agency whose mission is to establish and improve standards for financial reporting. The guidance issued by the FASB applies across a wide range of industries and, by design, is somewhat general in nature. More specific implementation guidance, especially when industry-unique circumstances must be addressed, is provided by other organizations such as the *American Institute of Certified Public Accountants (AICPA)*.

Because FASB is concerned only with private organizations (businesses), two other organizations have similar responsibilities for public entities. The *Government Accounting Standards Board (GASB)* has responsibility for overseeing the preparation of financial statements by state and local governments, while the *Federal Accounting Standards Advisory Board (FASAB)* has similar responsibilities for federal agencies.

> Key Concepts: GASB and GAAP
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> The *Government Accounting Standards Board (GASB)* is responsible for setting rules for the preparation of financial statements by state and local government entities. The rules established by GASB are known as *generally accepted accounting principles (GAAP)*.

The guidelines for the preparation of financial statements developed by the three organizations, along with amplifying information, are called *generally accepted accounting principles (GAAP)*. In essence, GAAP set the rules for the financial statement preparation game. Because the rules are different for private, state and local, and federal entities, there are three sets of GAAP. There are many complexities involved, so GAAP is a result of negotiation and compromise among the standard setting bodies and those organizations that must comply with the standards. Also, the standard setting organizations are continuously reviewing and revising the GAAP to ensure the best possible development and presentation of financial data.

For most organizations, the final link in the financial statement quality assurance process is the *external audit*, which is performed by an independent (outside) *auditor*. The results of the external audit are reported in the *auditor's opinion*, which is a letter attached to the financial statements stating whether or not the statements are a fair presentation of the organization's operations and financial position as specified by GAAP. There are several categories of opinions given by auditors. The most favorable, which is essentially a “clean bill of health,” is called an *unqualified opinion*. Such an opinion means that, in the auditor's opinion, the financial statements conform to GAAP, are presented fairly and consistently, and contain all necessary disclosures.

Self-Test Questions

1. Why are widely accepted principles important for the reporting of financial information?

2. What entities are involved in regulating the format and content of financial statements?

3. What does GAAP stand for, and what is its primary purpose?

4. What is the purpose of the auditor's opinion?

THE DIFFERENCE BETWEEN BUSINESS AND GOVERNMENT FINANCIAL STATEMENTS

A reasonable question to ask at this time is why is it necessary to have different sets of rules for business and government financial statements? The basic answer is this: To be most useful, financial statements must reflect the needs of the users of the statements. The primary users of government financial statements are citizens, elected representatives, oversight organizations, and creditors, while the primary users of business financial statements are capital suppliers (creditors and owners, who supply debt and equity capital).

> Key Concept: Government Uniqueness
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> Government financial statements differ from business financial statements for two primary reasons: (1) Governments must demonstrate accountability to the citizenry. (2) Governments provide a large variety of services, so information by service line is important to financial statement users.

The needs of citizens and oversight organizations focus on accountability for resources entrusted to the government, while the needs of investors emphasize information critical to making rational investment decisions. *Accountability* carries the responsibility to provide relevant and reliable information regarding the resources being managed. Although accountability information can be used to support decision making, it primary purpose is to fulfill citizenry's "right to know."

Of course, much of the financial information reported by businesses is relevant to government entities, but the accountability requirement means that government financial statements must contain additional information such as the following:

- Did the government's ability to provide services improve or degrade from the previous year?
- Were the current year taxes (or appropriations) and other sources of revenue sufficient to cover the costs of providing services?
- Was part of the burden of paying for services shifted to future taxpayers?
- How did the government finance its activities and meet its cash requirements?
- Will the government have the capacity to meet future obligations?
- What is the government's spending priorities?
- Has the government followed budgeting and legal guidelines?
- What resources are available for future use and to what extent are resources restricted to specific uses?
- Has the government provided its services in an efficient and effective way?

In addition to the accountability requirement, mission differences are also a major factor in driving the differences in financial statements between public and private entities. The purpose of government is to enhance the well-being of citizens by providing public services. For example, governments provide services such as public safety, education, health, and transportation. Such services typically are provided by governments rather than private entities because the economic incentives are not sufficient for businesses to provide such services at the appropriate quantity and price. In contrast, for-profit businesses focus on wealth creation, while not-for-profit businesses, such as community hospitals, typically focus on providing a single service (in this instance healthcare).

With these inherent organizational and mission differences in mind, here are some of the more important differences between government and business financial statements. First, the principal source of revenue for governments is taxation, while in businesses the principal source of revenue is the sale of goods and services. Thus, government financial statements require special treatment.

A second major difference is the requirement for governments to report the financial status of the services they provide. The idea here is that businesses are more concerned with profitability, while governments are more concerned with providing public services. This difference leads to the requirement for governments to report information on the efficiency, effectiveness, and sustainability of individual services, something not required of businesses. The major means of accomplishing this requirement is by breaking down the financial information into *funds*, which are "pots" of money designated for a single purpose that cannot be used for any other activity.

The key point here is that governments are fundamentally different from businesses. As a result, the financial statements of government entities differ from the financial statements of private organizations. Still, there are many similarities—in fact, the similarities are more pronounced than the differences. However, the unique environment and mission of governments mean that their financial statements have many features not seen in private statements.

Self-Test Questions

1. What are the primary organizational and mission differences between governments and private (business) entities?

2. What impact do such differences have on government financial statements?

GOVERNMENT FINANCIAL STATEMENT BASICS

The financial statements prepared by governments consist of two separate sets (formats), each containing two separate statements. First, governments prepare a set of *government-wide financial statements*. As the name implies, these statements contain information on the entire government entity as opposed to individual activities. This format reports both *governmental activities*, which are activities primarily funded by tax revenues, and *business-type activities*, which are activities primarily funded by fees charged for services provided. In addition, government-wide financial statements may contain information on *component units*, which are legally separate organizations, such as school districts, for which the elected officials are financially accountable.

> Key Concept: Financial Statement Formats
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> Government financial statements are created in two basic versions: *Government-wide financial statements* provide basic information broken down into governmental and business-type activities. *Fund financial statements* provide more detailed information about the government's individual activities. Because they provide different information, a complete financial analysis must consider both types of statements.

The second set of government financial statements consists of the *fund financial statements*. These statements provide detailed information about the government's most important funds. Each fund accounts for the assets and liabilities associated with a specific activity or category of activities. Because the fund financial statements provide more detailed information than the government-wide financial statements, they are more complex and require more time to analyze. In addition to format differences, there are some measurement differences between the government-wide and fund financial statements. However, these differences are beyond the scope of this tutorial.

The government-wide and fund statements contain different types of financial information, but neither type dominates the other. For information on the overall (aggregate) financial status of the government entity, see the government-wide financial statements. For information on individual activities, see the fund financial statements. Because governmental units are held accountable for a more complex set of goals than are businesses, both types of statements are necessary. The government-wide statements provide summary information that is more comparable both among different government entities and to business financial statements, while the fund financial statements allow the tracking of dedicated resources and provide additional details.

Both sets of financial statements contain a *notes* section. The notes provide information that helps explain the data contained within the financial statements. The notes are considered to be an integral part of the financial statements and the information they contain is necessary for a complete understanding of the financial statements and hence the government's financial status.

In addition to notes, standard setting bodies (such as FASB and GASB) can require businesses and governments to include additional information called *required supplementary information*. As its name implies, this information, although technically not a part of the financial statements, is deemed important enough to require reporting.

Self-Test Questions

1. Name the two basic formats of government financial statements?

2. What are the primary differences between government-wide and fund financial statements?

3. Explain the difference between notes and required supplementary information.

LOCAL GOVERNMENT FINANCIAL STATEMENT EXAMPLES (TANGELO COUNTY)

To illustrate a typical set of local government financial statements, consider Tangelo County, the location of the Tangelo County Health Department. Here, we will present examples of its government-wide financial statements to give you a feel for what financial statements are all about. (Financial statements prepared by states follow the same format.) Because a single tutorial cannot contain a thorough discussion of government financial statements, the focus here is on the two required government-wide statements: the statement of net assets and the statement of activities. (For more information on fund financial statements, see the Government Accounting Standards Board website at www.gasb.org.)

Statement of Net Assets

> Key Concept: Statement of Net Assets
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> The *statement of net assets* contains information on what a government owns, what is owes, and its net financial position as of a given point in time (usually the end of a fiscal (financial) year. This statement is similar to a business's balance sheet.

The *statement of net assets* presents a snapshot of the financial position of an organization **at a given point in time**, usually the end of a fiscal year. (A *fiscal*, or financial, year is the 12-month period used for budgeting and financial statement purposes. It often coincides with the calendar year, but many organizations, including most governments, have fiscal years that differ from the calendar year.) The statement of net assets reports what the organization owns, what it owes, and the difference between the two on the date the statement was prepared. Note that the statement of net assets changes every day as the government increases or decreases its assets or changes the composition of its liabilities. In non-government organizations, the statement of net assets is usually called a *balance sheet* or *statement of financial position*.

The statement of net assets has the following basic structure:

Assets:	*Liabilities:*
Current assets	Current liabilities
Noncurrent (long-term) assets	Noncurrent (long-term) liabilities
	Total liabilities
	Net Assets:
Total assets	Total net assets

The *assets* section of the statement lists, in dollar terms, all the resources owned by the organization. In general, assets are broken down into categories that distinguish short-lived (current) assets from long-lived (noncurrent) assets. The *liabilities* section lists the organization's payment obligations. Like assets, liabilities are separated by when they must be paid: current liabilities are obligations due in the coming year while noncurrent liabilities are payable at a later time.

The *net assets* section represents the excess of assets over liabilities: Total assets – Total liabilities = Total net assets. Total net assets can be thought of as the “value” of the organization—it is what remains if the assets were liquidated at their stated values and the liabilities were paid off from the proceeds. Because total net assets actually represent a “plug” in the statement of net assets, the left-hand side of the statement must equal the right-hand side. It is this relationship that gives the statement its generic name: the balance sheet.

Exhibit 1 contains a simplified representation of Tangelo County’s statement of net assets, which follows the basic structure explained above although the sections are arranged vertically. The title indicates that the statement is for Tangelo County and the data in the statement are for the fiscal year ended on September 30, 2011. The statement of net assets is not going to provide much information, if any, about the individual activities of the government. Rather, the statement will provide an overview of the economic position of the county as a whole.

Here is a line-by-line description of the Exhibit 1 cash flows:

Line 1. Line 1 begins the asset section of the statement of net assets. Note that the dollar data is divided into three columns: *governmental activities*, *business-type activities*, and *total*. The first column reports amounts devoted to traditional government activities that are financed primarily by taxes, such as public safety and parks and recreation. The second column reports on services that are funded primarily by user fees, such as water and sewer services, while the third column totals the first two. Note that the accounts in the assets section are listed in order of how quickly they can be converted to cash; cash itself is listed first and capital assets (land, buildings, and equipment) are listed last.

Line 2. The *current assets* heading indicates that the assets (resources) listed next either represent cash or assets that are expected to be converted into cash during the coming year, as opposed to assets that have longer lives.

Line 3. The first current asset listed shows $191,425,378 total in *cash and investments*. This total is split between government ($183,044,719) and business-type activities ($8,380,659). Cash represents actual cash in hand plus money held in commercial checking accounts. Investments reported on this line are short-term securities investments that are “readily convertible into cash,” which often are called *cash equivalents*. In general, accountants interpret that to mean securities that have a maturity of three months or less. Note that cash and cash equivalents are both reported on Line 3, so readers cannot determine the relative amounts of each type of asset, which confirms the fact that, for reporting purposes, they are considered to be identical in nature.

Line 4. Line 4 contains *investments* in securities that have a maturity of greater than three months but less than one year. Although these investments can be converted into cash quickly, they are not considered to be equivalent to cash as are the investments reported on Line 3. Organizations hold current (short-term) investments because cash and money held in commercial checking accounts do not earn interest. Thus, organizations should hold only enough cash and checking account balances to pay their recurring cash obligations—any funds on hand in excess of immediate needs should be invested in safe, short-term, highly liquid (but interest-bearing) securities. Even though short-term investments pay relatively low interest, any return is better than none, so such investments are preferable to cash holdings.

Line 5. Tangelo County lists $3,270,532 total in *receivables*, which represents money owed to the county in back taxes or for government services that have already been provided but not paid for.

Line 6. This line reports funds *due from other governments*; that is, money owed to the county by other government units, primarily at the state and federal levels.

Line 7. Line 7 lists the value of the county’s *inventories*, which consist primarily of expendable items such as fuel, supplies, parts, and other items used by the county in providing services. When purchased, inventory items are recorded as current assets on the statement of net assets. However, inventory costs are not shown as an expense on the statement of activities (discussed in the next section) until the items are actually used, at which time they are removed from the statement of net assets.

EXHIBIT 1 Tangelo County Statement of Net Assets for the Year Ended September 30, 2011

	Governmental Activities	Business-Type Activities	Total
1. **Assets:**			
2. *Current Assets:*			
3. Cash and investments	$183,044,719	$ 8,380,659	$191,425,378
4. Investments	1,940,373		1,940,373
5. Receivables	2,310,759	959,773	3,270,532
6. Due from other governments	11,930,705	8,255	11,938,960
7. Inventories	915,923		915,923
8. Total Current Assets	$200,142,479	$ 9,348,687	$209,491,166
9. *Noncurrent Assets:*			
10. Capital assets	$890,501,725	$22,497,911	$912,999,636
11. Less accumulated depreciation	(401,837,399)	(12,066,067)	(413,903,466)
12. Total Noncurrent Assets	$488,664,326	$10,431,844	$499,096,170
13. Total Assets	$688,806,805	$19,780,531	$708,587,336
14. **Liabilities:**			
15. *Current Liabilities:*			
16. Accounts payable and accrued liabilities	$ 15,242,905	$ 733,807	$ 15,976,712
17. Due to other governments	2,313,251	18,775	2,332,026
18. Accrued compensated absences	6,913,808	240,714	7,154,522
19. Bonds and notes payable	14,094,000		14,094,000
20. Total Current Liabilities	$ 38,563,964	$ 993,296	$ 39,557,260
21. *Noncurrent Liabilities:*			
22. Estimated self insurance liability	$ 5,011,483		$ 5,011,483
23. Bonds and notes payable	114,515,272		114,515,272
24. Total Noncurrent Liabilities	$119,526,755	$ 0	$119,526,755
25. Total Liabilities	$158,090,719	$ 993,296	$159,084,015
26. **Net Assets:**			
27. Invested in capital assets	$423,152,034	$ 10,431,722	$433,583,756
28. Restricted	105,156,052	3,796,513	108,951,565
29. Unrestricted	2,408,000	4,559,000	6,968,000
30. Total Net Assets	$530,716,086	$ 18,787,235	$549,503,321

Line 8. Line 8 totals the current asset accounts (Lines 3-7). Tangelo County reported $209,491,166 in total current assets at the end of its 2011 fiscal year. Suppose that the current assets shown on the statement at that time were all, except inventories, converted into cash (securities were allowed to mature and receivables due from individuals and governments were collected) at the values listed on the statement. All else the same, the county would have $191,425,378 + $1,940,373 + $3,270,532 + $11,938,960 = $208,757,243 in cash at the end of September 2012. Of course, all else will not be the same because much of this amount will be used to provide services, so the county's 2012 reported cash balance will undoubtedly be different from $208,757,243. Still, this little exercise reinforces the concept behind the current asset category; the **assumption** that these assets will be converted into cash during the next year.

Line 9. The *noncurrent assets* heading indicates that the assets (resources) listed next, unlike current assets, have maturities greater than one year.

Line 10. This line lists Tangelo County's *capital assets*; that is, its land, buildings, and equipment. Such assets also include infrastructure like roads, right of ways, bridges, sidewalks, and traffic signals. Capital assets are reported on the statement at cost. The costs of normal maintenance and repairs that do not add to the value of the assets or materially extend their useful life do not increase the values listed, but major outlays for improvements are added to the capital asset amounts on Line 10.

Line 11. Line 11 lists $413,903,466 in total *accumulated depreciation*. Because this amount is subtracted from the capital asset amounts listed on Line 10, it is listed as a negative value (in parentheses). The idea behind depreciation is to account for the wear and tear (loss of value) of capital assets. Accountants have specific rules that they use to determine the amount of deprecation—the end result being that the financial statement values of capital assets (except land) are reduced over time to reflect the expectation that their values will decrease with age and use.

Line 12. *Total noncurrent assets* reflect the total values of the long-term assets listed less accumulated depreciation (Line 10 – Line 11). Note that the $499,096,170 listed for total noncurrent assets reflects the *book value* (accounting value) of the assets rather than their *market value* (the amount that would be realized if the assets were sold).

Line 13. The *total assets* total value of $708,587,336 reflects the accounting value of Tangelo County's owned resources. Again, note that this value is the book (accounting) value and does **not** represent the market (sale) value of the county's resource holdings.

Line 14. Line 14 indicates the beginning of the *liabilities* section of the statement. Like assets, liabilities are listed in order of maturity; that is, obligations that are due earlier are listed first.

Line 15. The first liabilities listed are *current liabilities*, which are obligations that must be paid in the coming year.

Line 16. The *accounts payable and accrued liabilities* line tells readers how much the county owes for supplies and services. In essence, these are bills that have been received but not yet paid. Accounts payable list unpaid bills to vendors and suppliers, while accrued liabilities report wages (and payroll taxes) that have been earned by county employees but not yet paid. At the end of fiscal year 2011, the county owed $15,976,712 to vendors, suppliers, and employees. The amounts listed on Line 16 are reduced as the bills are paid.

Line 17. Line 17 is similar to Line 16 except that the amounts are *due to other governments* rather than to private parties.

Line 18. Line 18 reports *accrued compensated absences*. Many employees are paid for absences such as those due to vacations, holidays, and sickness. Employers must set aside funds to pay for such absences and the amount accumulated is reported here. Note that these funds are not held in the liability account, but rather are held in the cash and investments asset account (Line 3).

Line 19. Most governments use debt financing to supplement the funding obtained through taxes, fees, and grants. Some portion of the payments (principal and interest) for debt financing comes due in the next fiscal year while the remainder comes due in succeeding years. The dollar amount due in the coming year is reported as *bonds and notes payable*. (Amounts due beyond next fiscal year are reported on Line 23, which is in the noncurrent liability section.)

Line 20. Line 20 totals the current liability accounts (Lines 16-19). Tangelo County reported $39,557,260 in *total current liabilities* at the end of its 2011 fiscal year. As mentioned in our discussion of Line 8, the conversion of current assets into cash is expected, all else the same, to produce $208,757,243 in cash by the end of September 2012. This amount is more than is needed to pay off the $39,557,260 in total current liabilities outstanding at the end of 2011 as they become due in 2012, which indicates that the county should have no problem in paying its current (near-term) bills.

Line 21. Line 21 starts the *noncurrent liabilities* (long-term liabilities) section of the statement, which lists liabilities already incurred that are due more than one year into the future.

Line 22. Tangelo County sets aside funds to pay liability claims that are not covered by insurance policies carried by the county. This account, titled *estimated self insurance liability*, totaled $5,011,483 at the end of fiscal year 2011.

Line 23. Line 19 reported payments on debt financing that are due in the coming year. Here, on Line 23, those payments that are due beyond the coming year are listed with the same heading, *bonds and notes payable*. Even though the two lines (19 and 23) carry the same name, their positions on the statement convey different meanings.

Line 24. Line 24 totals the noncurrent liability accounts (Lines 22 and 23). Tangelo County reported $119,526,755 in *total noncurrent liabilities* at the end of its 2011 fiscal year.

Line 25. This line reports the *total liabilities* of the county. It sums the total current and total noncurrent liability lines (20 and 24.) Tangelo county reported $39,557,260 + $119,526,755 = $159,084,015 in total liabilities at the end of the fiscal year.

Line 26. Line 26 begins the *nets assets* section, the focal point of the statement of net assets. This section is actually a *residual*: Total assets - Total liabilities = Total net assets. To illustrate, consider the governmental activities (left) column: $688,806,805 in total assets less $158,090,719 in total liabilities equals $530,716,086 in total net assets. The idea here is that the amount of net assets reflects the *book value* (accounting value) of the county's assets after stripping out its liabilities (payment obligations).

Lines 27, 28, and 29. The net assets section is broken down into categories that give readers an indication of the "availability" of these funds for future use on county projects and programs. Line 27 shows that a total of $433,583,756 was *invested in capital assets*. Thus, these funds have already been "used" to acquire the county's existing land, buildings, infrastructure, and equipment reported as assets. Of the remaining net assets, $108,951,565 are listed on Line 28 as *restricted*, which means that they have been set aside for specific purposes, such as to pay for expected employee paid absences or to repay debt principal or to pay for specific public works projects. The final category, shown on Line 29 as *unrestricted*, are funds whose use has not been pre-designated. Note, however, that the amounts listed in the net assets accounts are not just "sitting around" ready to be spent. Every dollar of total net assets is invested, along with the dollars of financing provided by the county's liabilities, in the assets listed on the statement. Only the cash portion of Line 3 (cash and investments) is available for immediate spending.

Line 30. Line 30 lists the *total net assets* of the organization (Line 27 + Line 28 + Line 29). Again, it is important to recognize that this amount is a "plug" in the sense that it reflects the difference between total assets and total liabilities. If total assets decrease but total liabilities stay steady, net assets also must decrease. Similarly, if total liabilities increase but total assets remain constant, net assets again must decrease. Finally, as explained earlier, note that the statement of net assets balances: Total assets = Total liabilities + Total net assets = $708,587,336 = $159,084,015 + $549,503,321.

The statement of net assets contains a great deal of information about the financial status of a government. In fact, actual statements contain much more information than indicated by Exhibit 1 as the illustration was simplified. For purposes of this tutorial, a rough understanding of the statement's format and contents is sufficient.

To summarize the statement of net assets, you can use this statement to:

- Identify what types of assets a government owns, what types of debt it uses, and the nature of the net assets that remain.
- Learn about the government's capital (long-lived) assets, including a rough idea of the age and condition of the assets and the efforts to maintain them.
- Assess the ability of the government to continue to provide services in the future.
- Find out how much of the net assets can be used to provide new services versus how much is currently invested in capital assets or restricted to specific purposes.

Statement of Activities

Whereas the statement of net assets presents a snapshot of a government's financial position **at a given point in time**, the *statement of activities* reports on a government's activities **over some period of time**, usually a fiscal year.

> Key Concept: Statement of Activities
>
> The *statement of activities* reports the costs of government activities over some period, often a year, and how these costs were paid. Expenses are broken down by function and revenues are listed either by function or as general (tax) revenues. The bottom line of the statement tells whether the government has generated excess funds over the period or was forced to use reserves to pay for the services provided.

In many ways, the statement of activities is similar to an *income statement* for a business. However, the format of the statement of activities is designed to report the financial status of each of the primary functions of government. This is accomplished by first reporting the expenses of each function and then reporting any revenues (fees) collected to directly support that function. The idea here is that government functions require financial resources, but some of the costs may be offset by program revenues. If the function's revenues exceed its costs, that function is self-supporting. However, if the function's costs exceed its revenues, that function must be supported by other revenue sources, typically tax revenues. When all functions costs and revenues are totaled, the end result is the amount of total government expenses that must be covered by tax revenues.

The next section on the statement of activities reports general revenues, which for the most part are obtained from taxes. Finally, the statement of activities reports the change in net assets for the year, which is nothing more than the difference between total expenses and total revenues. This is the "bottom line" measure for a state or local government. It shows whether a government's financial position improved or declined for the year and is carried over to the statement of net assets as reflected in the end-of-year total net assets value.

Exhibit 2 contains a simplified representation of Tangelo County's statement of activities, which follows the basic structure described above. The timing of the statement of activities is apparent in the title; it is for the fiscal year that ended on September 30, 2011. Often, data for the most recent two years are reported.

EXHIBIT 2 Statement of Activities for the Year Ended September 30, 2011

	Expenses	Fees for Service	Operating and Capital Grants	Net (Expense) Revenue
1. Governmental Activities:				
2. Administration	$ 43,513,311	$ 5,906,521	$ 1,034,507	($ 36,572,283)
3. Community services	18,267,769	475,270	928,339	(16,864,160)
4. Corrections	27,977,357	549,392	84,997	(27,342,968)
5. Courts	22,516,808	7,391,213	2,425,667	(12,699,928)
6. Emergency services	30,861,300	7,953,675	445,925	(22,461,700)
7. Law enforcement	33,149,063	2,350,681	3,981,521	(26,816,861)
8. Transportation	42,820,787	383,512	4,255,011	(38,182,264)
9. Interest on long-term debt	4,510,052			(4,510,052)
10. Total Governmental Activities	$223,616,447	$25,010,264	$13,155,967	($185,450,216)
11. Business-Type Activities:				
12. Solid waste services	$ 13,038,175	$13,522,568	$ 5,015	$ 489,408
13. Codes enforcement	1,373,495	1,126,126		(247,369)
14. Total Business-Type Activities	$ 14,411,670	$14,648,694	$ 5,015	$ 242,039
15. Total All Activities	$238,028,117	$39,658,958	$13,160,982	($185,208,177)
16. General Revenues:				
17. Property taxes				$135,672,018
18. Fuel taxes				10,769,554
19. Other taxes				31,183,493
20. Interest earnings				4,149,454
21. Total General Revenues				$181,774,519
22. Change in Net Assets:				($ 3,433,658)
23. Net assets, beginning				$552,936,979
24. Net assets, ending				$549,503,321

Here is a line-by-line description of the Exhibit 2 cash flows:

Line 1. Line 1 indicates that the following lines provide expense and revenue information on traditional *governmental activities*. A later section of the statement of activities will report business-type activities.

Lines 2-8. These lines list the government functions (activities) of Tangelo County by broad category. For example, consider Line 2 (*Administration*). The expenses column indicates that the administration function cost the county $43,513,311 during fiscal year 2011. However, this cost was partly offset by $5,906,521 in fees collected for administrative services and $1,034,507 in operating and capital grants. The end result is a net expense of $43,513,311 - $5,906,521 - $1,034,507 = $36,572,283. Note that the rightmost column, labeled *net (expense) revenue* shows the net amount in parentheses, which indicates a negative value, or expense. When activities show net expenses, function revenues are less than function expenses, and hence the function must be supported by general (tax) revenues. In essence, a positive amount in the right-most column means that program revenues exceed program expenses, and hence the function makes a positive contribution to the financial well-being of the organization, while a negative value indicates that the function loses money and hence requires financial support from general revenues. Lines 3-8 report the results of other county functions in a similar manner.

Line 9. As indicated on Lines 19 and 23 of the statement of net assets (Exhibit 1), Tangelo County has $128,609,272 of long-term debt (notes and bonds) outstanding at the end of 2011. This debt required interest payments of $4,510,052 during 2011, which is reported as *interest on long-term debt.*

Line 10. This line, *total governmental activities*, totals the amounts listed in Lines 2-9. When all governmental activities are considered, the county had $223,616,447 in expenses, $25,010,264 in fees collected, and $13,155,967 in operating grants, for a total net expense of $185,450,216.

Line 11. Line 11 indicates that this section lists expenses and revenues from *business-type activities* (as opposed to the governmental activities listed in the first section). For Tangelo County, two activities have been identified as business-type activities, which are financed primarily by fees charged to users.

Line 12. *Solid waste services* reflect the costs and revenues associated with the county's garbage pickup and disposal services. In 2011, solid waste services generated a net revenue of $489,408, indicated by the positive value in the right-hand column. Thus, this amount is available to help offset the net expenses incurred by governmental activities.

Line 13. Unlike the solid waste disposal services reported on Line 12, the *codes enforcement* activity did not generate a surplus (net revenue). Rather, Line 13 reports a net expense of $247,369, which indicates that the fees for this activity were insufficient to cover costs.

Line 14. Line 14, *total business-type activities*, totals Lines 12 and 13. Considering the two business-type activities, Tangelo County generated a net revenue of $242,039.

Line 15. This line, *total all activities*, sums Lines 10 and 14. Here we see that activity expenses for 2011totaled $238,028,117, fees collected totaled $39,658,958, and grants totaled $13,160,982, resulting in a net expense for the county of $185,208,177. This is the net amount that must be covered by the general revenues (taxes and interest earnings) reported in the next section for Tangelo County to break even for the year.

Line 16. Line 16 signifies the beginning of the *general revenues* section, which includes three types of tax revenues and interest earnings.

Lines 17-19. These lines report the county's general tax revenues. Line 17 reports *property taxes* of $135,672,018, Line 18 lists *fuel taxes* of $10,769,554, and Line 19 lists *other taxes* of $31,183,493.

Line 20. Line 20, *interest earnings*, reports the interest earned on monies invested by the county. Lines 3 and 4 of the statement of net assets (Exhibit 1) indicate that Tangelo County had over $193,000,000 in cash and investments at the end of 2011. Because cash is a nonearning asset, most of these funds are invested in securities that pay interest. The earnings on such investments, $4,149,454, are reported here.

Line 21. Line 21 totals the general revenues reported on Lines 17-20. For 2011, the county reported $181,774,519 in *total general revenues*.

Line 22. Line 22, the most important single line on the statement of activities, reports the *change in net assets*, which is calculated as Total all activities net (expense) revenue + Total general revenues = Line 15 + Line 21 = ($185,208,177) + 181,774,519 = ($3,433,658). This is a negative amount, so in 2011 Tangelo County's total expenses exceeded its total revenues, which is not a good thing. In essence, Line 22 reports the county's "profitability" for the year. Because of reserves and the ability of governments to reduce expenses in the future, one or even a few years of a negative change in net assets does not spell disaster. Still, the financial ability of a government to meet mission needs is dependent on a sound financial condition, which means that revenues must exceed expenses over the long run.

Lines 23 and 24. Lines 23 and 24 reconcile the statement of activities and the statement of net assets. Line 23 lists the *net assets, beginning,* which are taken from the 2010 statement of net assets (not shown in this tutorial). Line 24, *net assets, ending,* which sums Lines 22 and 23, must match the amount listed for total net assets on the 2011 statement of net assets. We see that this value, $549,503,321, is listed both on Line 24 of Exhibit 2 and Line 30 of Exhibit 1.

The statement of activities contains a great deal of information about a government's expenses, revenues, and overall "profitability." In fact, actual statements contain more information than indicated by Exhibit 2 because the illustration was simplified. For purposes of this tutorial, a rough understanding of the statement's format and contents is sufficient.

To summarize the statement of activities, you can use this statement to:

- Learn where a government gets its financial resources from and how those resources are used.
- Find out how much it costs to provide major programs and services.
- Determine the extent to which services cover costs through user fees, charges, and grants, as opposed to being funded with current tax revenues or reserves accumulated from past years.
- Identify unusual costs or sources of funding.
- Discover if the revenues raised during the year were sufficient to cover costs, and hence whether a government's financial condition is improving or declining.

Self-Test Questions

1. What types of information are contained in the statement of net assets? In the statement of activities?

2. Explain the differences between an asset, liability, and net asset.

3. What is the difference between a current account and a noncurrent account?

4. What is the difference between a governmental and business-type activity?

5. Are all governmental services paid for by general taxes? Explain your answer?

6. Do governments report a "profitability" measure? If so, where?

7. What is the numerical connection between the statement of activities and the statement of net assets?

LOCAL HEALTH DEPARTMENT FINANCIAL REPORTING

Key Concept: LHD Financial Reporting

Local health departments (LHDs) are required to report financial data to a variety of government agencies. Most commonly, LHDs report financial data (along with demographic, population health status, and workforce information) broken down by individual activities (programs) as well as in the aggregate. The data often are entered directly into a state data base where is used to assess the performance of the public health system.

Local health departments (LHDs) are required to report data needed for public health system management to various entities depending on the type of state public health system. The specific data elements vary, but all states require financial, demographic, population health status, and workforce information. Within each broad category, data are both aggregated and broken down by specific activity (program). LHDs often report data online to facilitate analysis at both local and state levels.

Exhibit 3 contains a somewhat abbreviated version of the state financial reporting requirements of the Tangelo County Health Department (TCHD). The state uses an online system in which TCHD personnel enter the data directly into the state's public health reporting system. TCHD reports annual financial data, which are used both for budgeting and financial condition analysis purposes. Note that the focus in this module is solely on financial data, but the overall reporting requirements include a large amount of nonfinancial data.

The financial data are broken into two major divisions and six sections. The first major division lists aggregate data. Section 1 (*revenues*) reports the TCHD's annual revenues by revenue source. For this year, TCHD reported $16,228,647 in total revenues obtained from nine different sources. The source providing the greatest amount of revenue was the state, which provided $6,900,167, or $6,900,167 ÷ $16,228,647 = roughly 43 percent of total revenues. The smallest contributor to revenues was Medicare, which paid $128,143 or less than 1 percent of the total.

Section 2 reports expenses (*expenditures*), which total $15,616,645. Clearly, TCHD's largest expense is for labor, which totals $9,113,603 + $3,047,526 = $12,161,129 in salaries and fringe benefits. This total represents almost 80 percent of TCHD's expense structure.

Sections 3 and 4 report miscellaneous information. Section 3 (*fund balances*) lists $1,675,125 as the *general fund balance*. This is the amount of reserves that TCHD had on hand at the end of the year. Section 4 (*other financial data*) lists two pieces of financial information. *Accounts receivable* indicates that $457,518 was owed to TCHD from various sources, such as Medicaid, often for medical services provided to beneficiaries. Presumably, the vast majority of these funds will be collected in the near future. The final line, *total amount written off*, indicates that $72,378 of receivables that were owned to TCHD at the beginning of the year were declared uncollectible during the year and hence removed (written off) from the receivables balance.

The second major division, which contains two sections, provides a breakout of specific categories of revenues and expenses. Note that the revenues and expenses listed here are portions of the same revenues and expenses listed in Sections 1 and 2. Section 5 (*revenues*) provides information on selected revenue categories as opposed to revenue sources. Because only selected categories are presented, the revenues in this section do not add up to the total revenues reported in Section 1. It is interesting to note here that the greatest single category of revenues reported here is medical services revenues, which means that fees and charges for services are an extremely important sources of revenue for TCHD. (Note that not all LHDs provide clinical services. In some states, LHDs provide only population health services.)

Section 6 (*expenditures*) lists selected categories of expenses. Here we see that $2,286,614 (roughly 15 percent) was spent on administration as compared to $13,330,031 (about 85 percent) spent on programs. As with any organization, higher administrative expenses means that fewer dollars are available for mission-related activities. This section also lists the amounts spent on selected activities. For example, $953,179 was spent on environmental health activities.

EXHIBIT 3 Sample Tangelo County Health Department Annual Financial Reporting Requirements

Aggregate Data:

1. Revenues:

Federal revenues (Excluding Medicaid and Medicare)	$ 1,675,170
State revenues	6,900,167
County revenues	1,036,451
Medicaid revenues	2,345,370
Medicare revenues	128,143
Fees from medical services	683,999
Fees from environmental health services	503,897
Fees from vital statistics	311,595
Other revenues	2,643,855
Total Revenues	$16,228,647

2. Expenditures:

Salaries	$ 9,113,603
Fringe benefits	3,047,526
Expenses	3,124,166
Other	325,701
Fixed capital outlays (construction/renovation)	5,650
Total Expenditures	$15,616,645

3. Fund Balances:

General fund balance	$ 1,675,125

4. Other Financial Data:

Accounts receivable	$ 457,518
Total amount written off	$ 72,378

Specific Revenue and Expenditure Breakouts:

5. Revenues:

Restricted (categorical) revenues	$ 2,444,725
Grant revenues	$ 3,398,258
Environmental health revenues	$ 620,613
Dental revenues	$ 70,684
Immunization revenues	$ 676,045
Medical services revenues	$ 5,382,495

6. Expenditures:

Administrative expenditures	$ 2,286,614
Program expenditures	$13,330,031
Laboratory expenditures	$ 514,208
Public health preparedness expenditures	$ 630,360
Chronic diseases expenditures	$ 366,641
Medical services expenditures	$ 6,097,197
Pharmacy expenditures	$ 363,778
Environmental health expenditures	$ 953,179
Dental expenditures	$ 78,951
Immunization expenditures	$ 1,052,886

Exhibit 3 is meant to give you some idea of the types of financial information that LHDs report to various entities. The idea behind financial reporting is to provide sufficient data to supervisory agencies to allow them to assess the financial performance and status of the reporting government unit.

Self-Test Questions

1. What are the typical financial reporting requirements of LHDs?

2. What types of information are reported by LHDs?

3. What does the general fund balance represent?

4. What is a receivable? Why are receivables "written off?"

KEY CONCEPTS

Financial reporting is required of all governments and government agencies, including public health organizations. Thus, it is important that all public health managers have a basic understanding of financial reporting requirements and the types of information reported. The key concepts of this tutorial are:

- *Financial statements* are formal reports of the financial status and activities of businesses and governments.

- The predominant users of financial statement information are those parties who have a *financial interest* in the organization and hence are concerned with its economic status.

- The *Securities and Exchange Commission (SEC)*, an independent regulatory agency of the U.S. government, has the authority to establish and enforce the form and content of financial statements.

- The SEC has delegated the responsibility for establishing standards for private entities (businesses) to the *Financial Accounting Standards Board (FASB)*—a non-government entity whose mission is to establish and improve standards for financial reporting.

- Because FASB is concerned only with private organizations, two other organizations have similar responsibilities for public entities. The *Government Accounting Standards Board (GASB)* has responsibility for overseeing the preparation of financial statements by state and local governments, while the *Federal Accounting Standards Advisory Board (FASAB)* has similar responsibilities for federal agencies.

- The primary users of government financial statements are citizens, elected representatives, oversight organizations, and creditors, while the primary users of business financial statements are debt and equity investors (creditors and owners).

- While the needs of investors emphasize financial information critical to making rational investment decisions the needs of citizens and oversight organizations focus on *accountability* for resources entrusted to the government. Although much of the financial information reported by businesses is relevant to governmental units, the accountability requirement means that government financial statements must contain additional information.

- The financial statements prepared by governments consist of two different sets. The first set is the *government-wide financial statements*, which contain information on the entire organization's activities. These statements include *governmental activities*, which are activities primarily funded by tax revenues, and *business-type activities*, which are activities primarily funded by fees charged for services provided.

- The second set of financial statements is the *fund financial statements*, which provide detailed information about the major individual activities, or *funds*, of a government. This tutorial focuses on the government-wide financial statements.

- The *statement of net assets* presents a snapshot of the financial position of a government **at a given point in time**, usually the end of the fiscal year. The statement reports what the organization owns, what it owes, and what is left on the date the statement was prepared. In private organizations, the statement of net assets is usually called a *balance sheet* or *statement of financial position*.

- The *statement of activities* reports on a government's activities **over some period of time**, usually a fiscal year. The statement presents the revenues and expenses of the organization, and hence is similar in many ways to a business's *income statement*.

- Local health departments (LHDs) must report data needed to manage the public health system to various entities depending on state requirements. Although the specific data elements vary, all states require financial, demographic, population health status, and workforce information both by activity (program) and in the aggregate.

This tutorial discusses financial reporting by public health organizations. Unfortunately, the reporting requirements vary depending both on the level of the organization (federal versus state versus local) and the type of state public health system. The diversity of financial reporting requirements and information required means that public health managers must be familiar with the unique requirements of their particular organizations. Also, it should be obvious to readers that it is not easy to interpret the financial data reported within the public health system. The next module in this tutorial series (Module VI: Assessing Financial and Operating Condition) will discuss the techniques used to help analyze and interpret financial data.

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