Notes to the Financial Statements

FOCUS
George Mason University

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Basic Considerations

- Communicate information essential to fair presentation that is not displayed on face of financial statements
- Notes form an integral part of basic financial statements
- Notes should focus on primary government and reference business-type activities [GASB Codification 2300.102]…
Basic Considerations (contd.)

- Some information may be presented either on face of statements or in notes
  - Disclose in notes only if not presented on face of statements [2300.103]
- Notes should not be cluttered with unnecessary and immaterial disclosures
  - Circumstances and materiality must be considered in determining what to include [2300.108]
Notes Essential to Fair Presentation

- Contained in various GASB standards: NCGA 1, NCGAI 6, GASB 9, GASB 14, GASB 25, GASB 27, GASB 31, GASB 34, GASB 38, GASB 39, GASB 43, GASB 45, GASB 48, and GASB 50 (and others when applicable)
  - Level A within the GASB GAAP hierarchy
- Consolidated in GASB *Codification Section 2300—Notes to Financial Statements*
  - Level A GAAP
Significant Accounting Policies
Statements Described

- Description of government-wide financial statements
  - Statement of Net Assets
  - Statement of Revenues, Expenses, and Changes in Net Assets
  - Statement of Cash Flows

  Technically a fund statement but should be addressed [2300.106.a.(1)]
Reporting Entity / Component Units

- Reporting entity should be described
- Distinguish between primary government (PG) and any component unit(s) (CU)
- Identify status of PG as component unit if applicable
  - Description of reporting entity technically is not an accounting policy but should be included...
Unlike many matters with required notes, professional judgment plays a key role:
  - Both in determining whether a CU should be reported and, if so, which disclosures are required.

- Clearly differentiate between disclosures for PG and CU.
- Decisions about disclosures should be made on a CU-by-CU basis…
Reporting Entity / Component Units (contd.)

- Brief description of the CU(s) and relationship to PG
- Discussion of criteria for selection as CU
  – Merely citing GASB 39 is not sufficient
- How reported—blending versus discrete display
- How to obtain CU financial statements
  [2300.106.a.(2)]
Description of measurement focus and basis of accounting used in government-wide statements

- Reference business-type activities
- Economic resources measurement focus
- Accrual basis of accounting [2300.106.a.(4) and 1600.130]
Eliminations

Describe policy for eliminating internal activity in the statement of activities [2300.106.a.(6)]
Capitalizing Assets

Describe policy for capitalizing assets and estimating useful lives of those assets [2300.106.a.(7)]
Operating Versus Nonoperating

Policy for defining operating and nonoperating revenues [2300.106.a.(9)]
Applying FASB Pronouncements

- Describe the policy for applying FASB pronouncements issued after November 30, 1989 [2300.106.a.(10)]
Cash and Cash Equivalents

Define cash and cash equivalents as used in the statement of cash flows [2300.106.a.(11)]
Applying Restricted Versus Unrestricted Funds

Describe the policy regarding whether to first apply restricted or unrestricted funds when an expense is incurred for purposes for which both restricted and unrestricted net assets are available [2300.106.a.(12)]
Questions?
Other Required Disclosures
Cash Deposits with Financial Institutions

- Legal or contractual provisions for deposits
- Deposits as of statement of net assets date and during the period
- Any significant violations of legal or contractual provisions for deposits
- Custodial credit risk and foreign currency risk
- Deposit policies related to risks, or indication that exposure exists but policies have not been established [2300.106.b and C20.103-110]
Investments

- Methods and significant assumptions used to estimate fair value when not relying on quoted market prices
- Policy for determining which investments, if any, reported at amortized cost
- For investments in non-SEC-registered external investment pools, describe regulatory oversight and whether fair value is same as value of pool shares…
Any involuntary participation in an external investment pool

Methods used to estimate value of investments in pools if pool sponsor does not provide information, and reasons why estimate was necessary

Income from investments associated with one fund assigned to another fund…
Investments (contd.)

- Legal or contractual provisions for investments, including reverse repurchase agreements
- Investments, including reverse repurchase agreements, as of statement of net assets date and during the period
- Following disclosures should be organized by investment type (e.g., U.S. Treasuries, corporate bonds, or commercial paper)…
Investments (contd.)

- Legal or contractual provisions
- Significant violations of legal or contractual provisions
- Describe investment policies related to following risks (and the risks themselves)
  - Credit risk
  - Custodial credit risk
  - Concentration of credit risk…
Investments (contd.)

- Interest rate risk
- Foreign currency risk
- Additional disclosures for some very rare occurrences not likely to affect higher education [2300.106.c and I50.122-136]
Contingent Liabilities

- Contingent liabilities not requiring accrual, including all significant facts
- If no accrual is made for loss contingency because it is not probable or the amount or range of amounts cannot be estimated, disclosure should be made indicating the nature of the loss contingency [2300.106.d, 1500.114, and C50.115]
Subsequent Events

- Significant effects of subsequent events [2300.106.f]
Annual Pension Cost / Net Pension Obligations

For each defined benefit pension plan (though combining information is appropriate to avoid unnecessary duplication)

- Plan description including name, entity administering plan, identification of plan type (e.g., single employer, agent employer)

- Description of types of benefits and authority under which benefits are established or may be amended…
Annual Pension Cost / Net Pension Obligations (contd.)

- Whether a stand-alone financial report is issued or the plan is included in the report of another entity and how to obtain the report
  - Funding policy

- Authority under which obligations to contribute by plan members, employer(s), and other entities are established or may be amended...
Annual Pension Cost / Net Pension Obligations (contd.)

- Required contribution rates of active plan members and employer

- Sole / agent employers must also disclose
  - Details about pension cost, contributions, and net pension obligation
  - For current and two preceding years, additional information about pension cost, percentage of cost contributed each year, net pension obligation at end of each year
Annual Pension Cost / Net Pension Obligations (contd.)

– Funded status and various actuarial information
– Actuarial methods and assumptions…

For each defined contribution pension plan (though combining information is appropriate to avoid unnecessary duplication)

– Plan name, entity administering plan, identification of plan as defined contribution…
Annual Pension Cost / Net Pension Obligations (contd.)

– Plan description, provisions, authority under which plan was established or may be amended

– Contribution requirements for plan members, employer, and other contributing entities and authority under which requirements were established or may be amended…
Annual Pension Cost / Net Pension Obligations (contd.)

– Contributions actually made by plan members and employer [2300.106.g, P20.117-118, and P20.124]
Annual OPEB Cost / Net OPEB Obligations

For each *defined benefit* OPEB plan (though combining information is appropriate to avoid unnecessary duplication)

– Plan description

– Funding policy

Sole / agent employers must also disclose

– Details about OPEB cost, contributions, and net OPEB obligation if one exists…
Annual OPEB Cost / Net OPEB Obligations (contd.)

- For current and two preceding years, additional information about OPEB cost, percentage of cost contributed each year, net OPEB obligation at end of each year
- Funded status and various actuarial information
- Actuarial methods and assumptions…
Annual OPEB Cost / Net OPEB Obligations (contd.)

For each *defined contribution* OPEB plan (though combining information is appropriate to avoid unnecessary duplication):

– Plan name, entity administering plan, identification of plan as defined contribution
– Plan description, provisions, authority under which plan was established or may be amended…
Annual OPEB Cost / Net OPEB Obligations (contd.)

– Contribution requirements for plan members, employer, and other contributing entities and authority under which requirements were established or may be amended

– Contributions actually made by plan members and employer [2300.106.h, P50.120-121, and P50.127]
Violation of Finance Provisions

- Significant violations of finance-related legal or contractual provisions
- Actions taken to address such violations [2300.106.i and 1200.112]
Debt Service Requirements

- Principal and interest requirements, presented separately, for each of five subsequent fiscal years and in five-year increments thereafter
- Terms by which interest rates change for variable-rate debt [2300.106.j and 1500.118]
Operating Lease Commitments

- Commitments under noncapitalized (operating) leases
- Specific reference is made to FASB 13 disclosure requirements
  - Will change when GASB 62 takes effect (by FY 2012-13) [2300.106.k and L20.125]
Construction Commitments

Construction and other significant commitments [2300.106.1]
Capital Assets

By major class of asset

- Beginning and ending balances, with accumulated depreciation presented separately from historical cost
- Capital acquisitions
- Sales or other dispositions
- Current-period depreciation expense, with amounts charged to each function...
Capital Assets (contd.)

- Capital assets not being depreciated should be disclosed separately from those being depreciated.

- For collections not capitalized describe collection and provide reasons for noncapitalization [2300.106.m, 2300.111-113, and 2300.115]
Long-term Liabilities

For long-term debt and other long-term liabilities
- Beginning and ending balances
- Increases and decreases separately presented
- Portions of each item due within one year
  [2300.106.n and 2300.114-115]
Deficits

- Deficit fund balance or net assets of individual nonmajor funds [2300.106.o]
Component Unit Transactions

For each major CU, the nature and amount of significant transactions with other discretely presented CUs or the PG [2300.106.q]
Donor-restricted Endowments

- Net appreciation on investments that is available for spending
  - How amounts are reported in net assets
- Identify state law addressing ability to spend net appreciation
- Policy for authorizing and spending investment income (e.g., spending rate, total return policy) [2300.106.r and 2300.117]
Questions?
Potentially Required Disclosures
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GASB Codification Section 2300.107 lists 36 separate disclosures that may be deemed necessary

– Appear as separate listings from a to zz—only those applicable to BTAs are presented here

  - Entity risk management activities
  - Segment information for enterprise funds…
Potentially Required Disclosures (contd.)

- Condensed financial statements for major discretely presented CUs
- Short-term debt instruments and liquidity
- Related-party transactions
- Nature of PG’s accountability for related organizations
- Capital leases
- Joint ventures…
Potentially Required Disclosures

(contd.)

- Debt refundings
- Nonexchange transactions that are not recognized because they are not measurable
- Unrestricted net asset designations
- Nature and amount of inconsistencies caused by transactions between CUs having different fiscal years or changes in CU fiscal year-ends...
Potentially Required Disclosures (contd.)

- Identification of the PG in whose financial report (i.e., Commonwealth of Virginia’s CAFR) a CU (e.g., public university) is presented and the nature of the relationship.

- Reverse repurchase and dollar reverse repurchase agreements.

- Securities lending transactions.

- Demand bonds…
Potentially Required Disclosures

*Pollution remediation obligations*

*On-behalf payments for fringe benefits and salaries (could be relevant if foundations are paying salaries for institution’s employees)*

*External investment pools reported as trust funds (only relevant if institution sponsors the pool)*
Potentially Required Disclosures
(contd.)

- Significant transactions / events that are unusual or infrequent but outside management’s control
- Discounts and allowances that reduce gross revenues when not reported on the face of the statements
- Disaggregation of receivable and payable balances…
Potentially Required Disclosures (contd.)

- Impairment losses, idle impaired capital assets, and insurance recoveries if not apparent on the face of the statements
- Termination benefits
- Future revenues that are pledged or sold
- Derivative instruments
Notes may be more informative when presented in a logical order

- GASB Codification Section 2300.901 presents a nonauthoritative sequence for notes derived from an appendix to NCGAI 6

Summary of significant accounting policies is required but it can be addressed in notes or as stand-alone document (with references on each page of financial statements) [2300.110]
Financial Statements Reviewed

- Christopher Newport University (2009)
- James Madison University (2010 unaudited)
- Norfolk State University (2009)
- University of Mary Washington (2009)
- Virginia Community College System (2009)
- Virginia Tech (2010)
  - Same as for MD&A last spring
Global Observations

- Generally very good disclosures by all institutions
  - Usually clear and easy to understand (within constraints of GASB requirements)
- Some differing treatment on some material items
- Note count ranges from a low of 16 notes to a high of 28…
Global Observations (contd.)

- Two institutions provide a table of contents—very helpful
- All but one institution include reporting entity disclosure as part of significant accounting policies
- All but one of the institutions with collections have opted not to capitalize the collections
- Two institutions include a note about income taxes…
Global Observations (contd.)

- Universal (or nearly universal) issues
- Constructive criticism, not necessarily blatant errors
- In some cases merely neutral observations
  - Too many references to specific GASB standards (e.g., 28, 34, 35, 39, 40)
  - No requirement to cite specific standards anywhere in notes except when initially issued and then when implemented…
Global Observations (contd.)

- Should simply acknowledge presentation is made in accordance with relevant GASB standards
  - And FASB standards issued before November 30, 1989 that do not contradict or conflict with GASB standards (until 2012-2013)

Comparable reference to FASB standards for component units when applicable…
Global Observations (contd.)

– Most do not include policy for eliminating internal activity in statement of activities
– Capitalization threshold is fairly consistent at $5,000 but one institution is at $2,000
– Four institutions apply restricted net assets first when both are available, one relies on case-by-case analysis, and one fails to disclose their policy…
Global Observations (contd.)

– Quite a mix in handling CU disclosures between separate notes or inclusion with PG’s notes on the topic
– Issues not addressed in any institution’s notes
  - Description of the financial statements
    - Having this in MD&A is not sufficient
  - Segment…
Global Observations (contd.)

- Nonexchange transactions not reported due to inability to measure
- Violations of finance-related legal or contractual provisions
- Deficit net assets in major funds
- Pollution remediation obligations
- Impairment losses
  - In these cases this is good news!...
Questions?
Institution A

- Fails to identify criteria for inclusion of CUs
- Fails to identify the specific categories of revenues pledged to the repayment of debt
- Disclosure for donor-restricted endowments does not mention the state law allowing appreciation to be spent…
Institution A (contd.)

Natural classification expenses in matrix note

- Salaries and benefits
- Utilities
- Scholarships
- Depreciation
- Services, supplies, and other
Institution B

- Fails to identify criteria for inclusion of CUs
- Fails to disclose policy related to post-November 30, 1989 FASB standards
- Fails to provide definition of cash and cash equivalents
- Fails to identify the specific categories of revenues pledged to the repayment of debt...
Institution B (contd.)

- Includes excessive disclosures for foundation (e.g., fair value of financial instruments, lines of credit)
- Disclosure for donor-restricted endowments does not indicate amount of net appreciation available for authorization for expenditure and where its reported in net assets...
Institution B (contd.)

Natural classification expenses in matrix note
- Salaries and wages
- Fringe benefits
- Services and supplies
- Scholarships
- Utilities
- Plant and equipment
- Depreciation
Institution C

Natural classification expenses in matrix note

- Compensation and benefits
- Contractual services
- Other supplies and materials
- Travel
- Operating expenses
- Scholarships and fellowships
- Sponsored programs subcontracts
Institution D

- Fails to identify criteria for inclusion of CUs
- Fails to disclose policy related to restricted funds when both restricted and unrestricted are available
- Fails to identify the specific categories of revenues pledged to the repayment of debt
- Transactions with CUs reported as related party transactions rather than CU transactions...
Separate note for “affiliated foundation” that doesn’t qualify as a CU includes condensed balance sheet
- Not material and should not be presented
- It is a related party so transactions could be disclosed as related party transactions

Notes for CU exclude foundation endowment note
- Should be included as its material
Institution D (contd.)

Natural classification expenses in matrix note
- Salaries and wages
- Fringe benefits
- Services and supplies
- Utilities
- Plant and equipment
- Depreciation

Scholarships and fellowships is omitted...
Institution D (contd.)

- Functional category expenses in matrix note
  - Standard higher education functional categories plus
    - Museum and cultural services
    - Should be academic support
    - Historical attraction management
    - Should be academic support, institutional support, or auxiliary enterprises
Institution E

- Fails to disclose required information related to endowments
  - Probably immaterial since most endowment is held by foundation
- Auxiliary activities note should be presented after notes as Supplementary Information...
Natural classification expenses in matrix note
- Salaries and wages
- Fringe benefits
- Services and supplies
- Scholarships and fellowships
- Utilities
- Plant and equipment
- Depreciation
Institution F

- Basis of presentation note refers back to fund-based model
  - No longer relevant
- Fails to disclose policy related to post-November 30, 1989 FASB standards
- Auxiliary activities note should be presented after notes as Supplementary Information
- Fails to disclose transactions with CU…
Institution F (contd.)

Natural classification expenses in matrix note
- Salaries and wages
- Fringe benefits
- Services and supplies
- Scholarships and fellowships
- Utilities
- Plant and equipment
- Depreciation
Financial Statement Issues

Questions, Comments, and Reactions

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