

Financial Reporting and Accounting

Financial reports are an essential oversight tool. There are two basic kinds of financial reports:

- **Interim Reports.** These include monthly reports, quarterly reports and mid-year budget reviews.
- **Annual Reports.** Well-managed public agencies typically prepare a report at the end of the year explaining revenues and expenditures levels.

In addition, local agencies that receive federal or other grant moneys may be subject to specific funder financial reporting requirements.¹

Good interim reporting identifies important trends in time for local officials to act on them before serious problems arise. Audited financial reports alert governing body members if there are irregularities in financial practices and financial reporting. Both kinds of reports require a solid financial information system to track revenues and expenditures and provide that information to decision-makers.

Questions to Ask

Interim Reporting

- What kind of reports do agency managers receive? What do they do with them?
- How often do elected officials receive interim financial reports? Does staff review the information in these reports with local officials?
- Do the reports provide meaningful information that gives local officials an accurate portrayal of the agency's current financial picture to date?
- Do the reports compare expectations with actual results? Do they discuss key variances between the two?

Some Financial Warning Signs

- Operating expenses exceeding revenues by more than five percent during the year
- Large mid-year variances in budgeted revenues and expenditures versus actual
- Inadequate or late financial reports
- Depletion of reserves to balance budget, for example if the reserves fall below ten percent of operating costs.
- Outstanding loans between funds at the end of the fiscal year
- Expenses exceeding revenues for two consecutive years, with the second year's deficit being larger than the first year's
- Debt service exceeds 10 percent of current revenues
- Increase in debt service as percentage of operating budget each year
- Qualified auditor's opinions
- Reports of internal control weaknesses from the agency's auditors with no corresponding plan to address (or repeated reports of such weaknesses from year to year)
- Large turnover in staff responsible for monitoring financial status

- Are there adverse patterns?
- Does staff have a plan to address problem areas?
- Are there inconsistencies or conflicting trends?
- Do the reports identify areas of uncertainty or risk in any forecasts contained in the reports?
- Do the reports frequently contain surprises (unexpected developments)?

Annual Reporting

- Are the annual financial reports prepared by a certified public accountant, in accordance with generally accepted accounting principles? Are these reports audited by an outside or independent auditor?
- Have all the required disclosures, for example, those required by the Governmental Accounting Standards Board (GASB—sometimes pronounced “gaz-bee”) been made?
- How long has the outside or independent auditor been auditing the agency? Does the agency periodically change auditors every few years to provide a fresh view of the agency’s financial practices and reports?
- What is the relationship between the auditor and both the agency staff and the governing body? Is the auditor getting the information he or she needs in a timely manner? Is communication open and encouraged?
- Are the audited annual financial reports timely—within six months after year-end?
- Should the agency have an audit committee to select and supervise the work of the outside or independent auditor?²
- Are the auditors' opinions “unqualified?” (An “unqualified” opinion means that the auditor concludes the agency followed all accounting rules and that its financial reports present an accurate picture of the agency's financial condition. A qualified opinion is a significant warning sign that demands attention from the governing body.)
- Does the auditor prepare a transmittal letter that clearly and concisely describes the agency's fiscal status?
- Does the auditor issue a letter to the governing body reporting on the agency’ internal controls?
- Does the agency follow the “Award for Excellence in Financial Reporting” guidelines of the Government Finance Officers Association?³ If not, why not?

To Access the Institute's resources financial management resources, including the complete version of this booklet, go to <http://www.ca-ilg.org/budgeting-finance>

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The Institute welcomes feedback on resource:

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References and Resources

Note: Sections in the California Code are accessible at leginfo.legislature.ca.gov. Fair Political Practices Commission regulations are accessible at www.fppc.ca.gov/index.php?id=52. A source for case law information is www.findlaw.com/cacases/ (requires registration).

- ¹ See Single Audit Act Amendments of 1996, OMB Circular A-133, the OMB Circular Compliance Supplement and Government Auditing Standards, www.whitehouse.gov/omb/financial_fin_single_audit.
- ² GFOA Recommendation: Audit Committees (2008), www.gfoa.org/downloads/caafrAudit_Committee_revised.pdf.
- ³ Available at www.gfoa.org/downloads/GENERALPURPOSECHECKLIST.pdf.