



State of Arizona Accounting Manual

Topic 10 Accounting and Reporting
Section 15 **Statewide Financial Reporting**
The CAFR and the AFR

Issued 09/15/15
Page 1 of 6

INTRODUCTION

This section of SAAM does not consist of enumerated policy statements or procedures; rather, this section of SAAM is intended to acquaint readers with the primary statewide financial reports and the principles that govern them.

Readers with limited exposure to or experience with governmental accounting and its terminology might benefit from reading SAAM 1010, “Governmental Accounting Primer,” before reading this section.

Each year, the State prepares two principal sets of financial statements, the Annual Financial Report (AFR) and the Comprehensive Annual Financial Report (CAFR). The former is prepared using Arizona’s Legal Budgetary Basis (LBB), while the latter is prepared in accordance with GAAP. These two sets of financial statements, both products of the GAO, are prepared for two different sets of users, each with its own interests.

OBJECTIVES AND CHARACTERISTICS OF FINANCIAL REPORTING

Financial reporting is a means of communicating financial information to users. Financial reporting is not an end in and of itself but is intended to provide information useful for many purposes. Financial reporting helps fulfill government’s duty to be publicly accountable. Financial reporting also helps to satisfy the needs of users who have limited authority, ability, or resources to obtain information and who therefore rely on the reports as an important source of information. For that purpose, financial reporting objectives should consider the needs of users and the decisions they make.

Among the users of a government’s financial reports are the general public, the media, investors, creditors, special interest groups, oversight groups, lawmakers as well as government leadership, management and staff.

Financial reporting should assist in fulfilling the government’s duty to be publicly accountable and should enable users to assess that accountability.

- Financial reporting should provide information to determine whether current-year revenues were sufficient to pay for current-year services. This also implies that financial reporting should show whether current-year citizens received services but shifted part of the payment burden to future-year citizens; whether previously accumulated resources were used up in providing services to current-year citizens;

State of Arizona Accounting Manual

Topic 10 Accounting and Reporting
Section 15 **Statewide Financial Reporting**
The CAFR and the AFR

Issued 09/15/15
Page 2 of 6

or, conversely, whether current-year revenues were not only sufficient to pay for current-year services, but also increased accumulated resources.

- Financial reporting should demonstrate whether resources were obtained and used in accordance with the entity's legally adopted budget; it should also demonstrate compliance with other finance-related legal or contractual requirements.
- Financial reporting should provide information to assist users in assessing the service efforts, costs, and accomplishments of the governmental entity. This information, when combined with information from other sources, helps users assess the economy, efficiency, and effectiveness of government and may help form a basis for voting or funding decisions. The information should be based on objective criteria to aid interperiod analysis within an entity and comparisons among similar entities.

Financial reporting should assist users in evaluating the operating results of the governmental entity for the year and the financial condition at the year's end.

- Financial reporting should provide information about sources and uses of financial resources. Financial reporting should account for all outflows by function and purpose, all inflows by source and type, and the extent to which inflows met outflows. Financial reporting should identify material nonrecurring financial transactions.
- Financial reporting should provide information about how the governmental entity financed its activities and met its cash requirements.
- Financial reporting should provide information necessary to determine whether the entity's financial position improved or deteriorated as a result of the year's operations.

Financial reporting should assist users in assessing the level of services that can be provided by the governmental entity and its ability to meet its obligations as they become due.

- Financial reporting should provide information about the financial position and condition of the governmental entity. Financial reporting should provide information about resources and obligations, both actual and contingent, current and noncurrent. The major financial resources of most governmental entities are derived from the ability to tax and issue debt. As a result, financial reporting should provide information about tax sources, tax limitations, tax burdens, and debt limitations.
- Financial reporting should provide information about a governmental entity's physical and or-her nonfinancial resources having useful lives that extend beyond the current year, including information that can be used to assess the service potential of those resources. This information should be presented to help users assess long-term and short-term needs.

State of Arizona Accounting Manual

Topic 10 Accounting and Reporting
Section 15 **Statewide Financial Reporting**
The CAFR and the AFR

Issued 09/15/15
Page 3 of 6

- Financial reporting should disclose legal or contractual restrictions on resources and risks of potential loss of resources.

Finally, financial reporting should assist users—the general public, elected and appointed officials, managers and employees—in making decisions. These decisions may be managerial, economic, social, political or investment-oriented.

For financial reporting to be of value it must exhibit certain characteristics.

- **Understandability.** Though governments are complex entities and tend to gain in complexity as they grow larger and have greater spheres of influence or more extensive charters, their financial reporting should be as simple, yet as thorough, as possible. This can be accomplished by providing explanations and interpretations that help to provide clarity. However, reports do not have to be completely understandable for any potential user. Users of the CAFR or AFR, for example, need and should have a working knowledge of governmental accounting concepts to appropriately interpret the AFR and the CAFR.
- **Reliability.** Financial reports should be verifiable and free from bias; they should faithfully represent what they purport to represent. Financial reports need to be comprehensive and nothing material should be omitted.
- **Timeliness.** Financial reports should be available soon enough to enable the reader to make decisions related to the information contained in the reports.
- **Consistency.** The same methods or principles should be applied within and between reporting periods and any changes and the effects of such changes should be appropriately disclosed.
- **Comparability.** Independent but similar entities should report similar information in a similar way.
- **Relevance.** The information contained in financial reports must be useful to the reader. Relevance encompasses many of the other characteristics such as reliability and timeliness.

The State of Arizona fulfills the objectives of financial reporting and complies with A.R.S. § 35-131 by issuing two financial reports each year. One is the CAFR, prepared in accordance with GAAP. The other is the AFR, prepared in accordance with the LBB. Compliance with GAAP and the LBB assures that the State's financial statements exhibit the requisite characteristics.

It is essential that all State agencies comply with the requirements of the Single Audit Act and provide all the necessary financial information required for the preparation of the CAFR and the AFR.

State of Arizona Accounting Manual

Topic 10 Accounting and Reporting
Section 15 **Statewide Financial Reporting**
The CAFR and the AFR

Issued 09/15/15
Page 4 of 6

THE ANNUAL FINANCIAL REPORT (AFR)

The primary purpose of the AFR is to disclose budgetary performance. For this reason, the Annual Report is not prepared on a basis consistent with GAAP; it is, instead, prepared on the LBB of accounting, reflecting the budgeting and appropriation methodology of the State of Arizona.

Examples of the State's AFR can be found at <https://gao.az.gov/financials/afr>, the GAO's Website. Details of the AFR are best gleaned by viewing them online. In brief, however, the AFR as prescribed by statute and prepared by the GAO contains the elements shown below.

AN AFR SCHEMATIC

- Financial Statements
 - General Fund Financial Statements
 - Comparative Balance Sheet
 - Statement of Changes in Fund Balance
 - Statement of Revenues, Expenditures and Changes in Fund Balance – Appropriation to Actual
 - Changes in Fund Balance
 - Statements of Expenditures – Appropriation to Actual
 - General Fund
 - Capital Outlay
 - Special Revenue Funds
 - Enterprise Funds
 - Internal Service Funds
 - Permanent Funds
 - Fiduciary Funds
 - Statements of Revenues, Expenditures and Changes in Fund Balance
 - Other Governmental Funds
 - Special Revenue Funds
 - Enterprise Funds
 - Internal Service Funds
 - Permanent Funds
 - Fiduciary Funds
 - Notes

State of Arizona Accounting Manual

Topic 10 Accounting and Reporting
Section 15 **Statewide Financial Reporting**
The CAFR and the AFR

Issued 09/15/15
Page 5 of 6

THE COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)

Every state and local government should, though is not legally bound to, prepare and publish a CAFR to communicate its financial position and results of operations to users of the financial statements. The purpose of the CAFR is to report the combined financial information of all component units of the reporting entity. The contents and format of the CAFR are prescribed by the GASB.

The CAFR contains sets of financial statements with two distinct perspectives. The government-wide financial statements use presentations and methodologies resembling those used in the private sector. The funds financial statements use, as their name implies, traditional fund accounting formats and techniques.

Examples of the State's CAFR can be found at <https://gao.az.gov/financials/cafr>, the GAO's Website. Details of the CAFR are best gleaned by viewing them online. In brief, however, the CAFR as prescribed by the GASB and prepared by the GAO contains the elements shown on the following page.

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State of Arizona Accounting Manual

Topic 10 Accounting and Reporting
Section 15 **Statewide Financial Reporting**
The CAFR and the AFR

Issued 09/15/15
Page 6 of 6

A CAFR SCHEMATIC

- An Introductory Section
- Management's Discussion and Analysis (MD&A)
 - The MD&A contains a discussion of the financial statements and condensed information concerning the financial position and results of operations, budget variances, capital asset and long-term debt activity, infrastructure issues and other known facts of interest to the reader.
- The Basic Financial Statements (this list is representative, but not all inclusive)
 - Government-wide Financial Statements (using the economic resources measurement focus and the accrual basis of accounting)
 - Statement of Net Position
 - Statement of Activities
 - Governmental Funds Financial Statements (using the current financial resources measurement focus and the modified accrual basis of accounting)
 - Balance Sheet
 - Statement of Revenues, Expenditures and Changes in Fund Balances
 - Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances to the Statement of Activities
 - Proprietary Funds Financial Statements (using the economic resources measurement focus and the accrual basis of accounting)
 - Statement of Net Position
 - Statement of Revenues, Expenses and Changes in Fund Net Position
 - Statement of Cash Flows
 - Fiduciary Funds Financial Statements (using the economic resources measurement focus and the accrual basis of accounting)
 - Statement of Fiduciary Net Position
 - Statement of Changes in Fiduciary Net Position
 - Required Supplemental Information
 - Combining Statements
 - Individual Fund Statements
 - Schedules
- Statistical Section