

# CAFR 101 – A Guide to Understanding Comprehensive Annual Financial Reports

## What is a CAFR? What does it report?

CAFR stands for Comprehensive Annual Financial Report . The CAFR is the City's set of financial statements that comply with the accounting requirements established by the Governmental Accounting Standards Board (GASB). It must be audited by an independent auditor using generally accepted government auditing standards.

## How is the CAFR different from a regular financial report, our quarterly reports or our budget?

A regular annual report typically presents only basic financial statements about the government. A CAFR, presents a wider variety of important information intended to help the reader properly understand the basic statements, such as note disclosures and statistical or trend information

The budget is a **plan** for a future fiscal period, typically a year, primarily showing how revenues are allocated towards Council priorities. The expenses show staffing, operational and capital resources needed to implement existing and new programs. The CAFR contains the **actual results** of the prior year's financial activities.

Quarterly reports present the City's position at a point in time and they generally review our progress in meeting budget estimates during the year.

## Who sets the rules for CAFRs?

**The Governmental Accounting Standards Board (GASB) sets the standards** governing the content of a CAFR. GASB is an arm of the Financial Accounting Foundation, which also administers the Financial Accounting Standards Board that establishes accounting standards for private companies.

When developing proposals for new standards, GASB **solicits feedback** from the governmental accounting community through a variety of avenues, including public hearings, public forums, task forces and focus groups. The primary feedback mechanism, however, is a request for written comments from GASB, which anyone can submit.

## How do I read a CAFR?

The CAFR consists of three sections: Introductory, Financial and Statistical.

The Introductory section orients and guides the reader through the report. The Financial section presents the entity's basic financial statements as well as notes to the statements and the independent auditors' report. The Statistical section provides additional financial and statistical data, including data about financial trends that may better inform the reader about the government's activities.

## How can a layperson quickly find the most useful items about the City's financial report?

Generally speaking, a reader can find the "high points" by reading through the Management Discussion and Analysis (MD&A) in the financial section. The MD&A describes the previous year's results and key factors influencing them; shows the entity's current financial condition; and provides an overview of likely future prospects.

## How do you analyze the numbers?

There are various peculiarities to local government that affect accounting, such as lack of profit motive, taxation and regulation, diverse operating units with diverse goals, and the nature of fixed assets in the public sector.

From a technical standpoint, budget performance, liquidity, reserves and debt/liabilities are criteria that are used by the analysts who rate our municipal tax-supported bonds for credit worthiness. For utility revenue bonds, criteria include the utility's operational performance and ability to meet its debt payments, its overall debt and liquidity/reserves. Trend data, located in the statistical section, helps the reader understand changes over time.

From a layperson or management standpoint, the following questions may be asked:

- 1. Are we better off or worse off than last year?**
- 2. What are the biggest financial risks to the City?**
- 3. Are we maintaining our biggest assets/infrastructure?**
- 4. Are we considering the future?**
- 5. Have we complied with all of our external and internal requirements?**
- 6. Is the story complete?**

From City management, here is our quick takeaway view of the Fiscal Year ending September 30, 2019.

### **1. Are we better off or worse off than last year?**

- a. We are experiencing increases in most revenues due to a strong local economy. Growth in residential population, as well as commercial growth is evident in the City's financial performance.
- b. The City's net position (similar to equity on a balance sheet) has increased to \$871.7M, from \$791.7M in FY18.
- c. Overall position has increased due to infrastructure investment, both by the City and assets contributed by developers.
- d. Strong overall budget performance in the City's General Fund - There was one major variance in General Government, which is due to the practice of budgeting a total personnel vacancy factor for the General Fund in this one department. These savings from various departments due to staffing turnover are realized in each of the departments. Revenues were much stronger than forecasted, resulting in a \$14.4M fund balance, which is 20% higher than FY18. A portion of this was set aside in the FY20 budget for increased contingency reserves.

### **2. What are our biggest risks from a financial standpoint?**

- a. The City's electric utility has financial and market risk associated with the cost of wholesale electric contracts. The City has a long position on energy, which requires settling excess energy during most months of the year in the market, making the utility susceptible to volatile pricing. The City has worked to reduce risk by actively managing the portfolio. The performance of the City's Electric Fund improved, with a change in net position of \$4.5 million.
- b. The City's Water Fund continues to experience strong growth and financial performance. Growth continues to increase demand for treated water and the City will continue to evaluate the timing for significant investment in water treatment plant capacity additions.
- c. In high growth communities, it is common to finance the demand for infrastructure through debt to ensure the taxpayers and ratepayers who will benefit from the infrastructure will contribute to the payment for the investment. The City's coverage ratios are strong in the

combined utility fund and its assessed valuation continues to grow. The net bonded debt per capita has increased from \$1,155 in 2010 to \$3,166 in 2019, however the major portion of this growth is due to voter approved taxes. City council reviews financial ratios, overlapping debt and the impact of the debt carefully before approving debt to be issued for projects during the budget process.

- d. The City has a strong reliance upon sales tax for general services such as streets, parks and public safety. The concentration of those taxpayers by industry is in the statistical section.

### **3. Are we maintaining our biggest assets/infrastructure?**

- a. The CAFR measures financial activity, but it is an imprecise way of viewing whether any maintenance is being deferred. Historical costs of construction that are reflected in the financial statements are not a good indication of future costs of replacement. To better assess maintenance of one of the largest asset classes, the Council adopted a "Pavement Condition Index" for street maintenance and has committed to setting aside maintenance funds to maintain the street network at an average of "85" or better, which is considered a good rating of condition. The City also regularly assesses other facility conditions, such as the animal shelter, fire stations, the library and the recreation center to determine necessary upgrades for HVAC, accessibility and other areas for improvement and considers capital maintenance proposals during the budget process.
- b. Citizens continue to approve a dedicated ¼ cent of sales tax that is dedicated to street maintenance, which generates around \$3.7million each year.

### **4. Are we paying attention to the future?**

- a. We should be diligent in meeting our current obligations and not delaying current obligations to future generations to pay. The City's pension obligations are an important component. The City is one of 866 entities that contributes to the Texas Municipal Retirement System for a hybrid defined benefit plan for its employees. The fiscal year end for TMRS is December, therefore the City's net pension liability is measured as of 12/31/18. The plan fiduciary net position as a percentage of total pension liability is 81.41%. Trend information is located at the end of the notes section in "Required Supplemental Information".
- b. We match our debt payments with the useful life of the asset being purchased by debt. For example, a fire truck is debt funded, but is amortized over 10 years, while a new street is amortized over 20 years. This matches our replacement cycle to the payment schedules.

### **5. Have we complied with our internal and external requirements?**

- a. Demonstrating compliance takes several forms, including reviewing the budget compliance in the supplementary individual fund financial statements as well as the auditors reports in the financial and compliance sections. The audit opinion is "unmodified", which means no weaknesses, deficiencies or noncompliance material to the financial statements are noted.
- b. The CAFR is a public document and is used to comply with bond covenants and associated Securities and Exchange Commission reporting.
- c. It is important to note that auditors do not review every transaction of the City, not do they give an opinion on the financial strength of the City. They are reporting that the financial statements are free of material misstatement.

### **6. Is the story complete?**

- a. There are various significant commitments that are noted in the financial statements, such as the City's wholesale power agreements, its water contracts, special financing agreements, and tax abatements. Reading the notes provides context for the numbers.
- b. Master plans, capital improvement plans and budgets are important documents that are forward looking, in contrast with the CAFR, which reports after the fact. These documents

should be reviewed to understand the City's plans for the future, as well as viewing the CAFR.