

# Chapter 18

## MUNICIPAL ACCOUNTING

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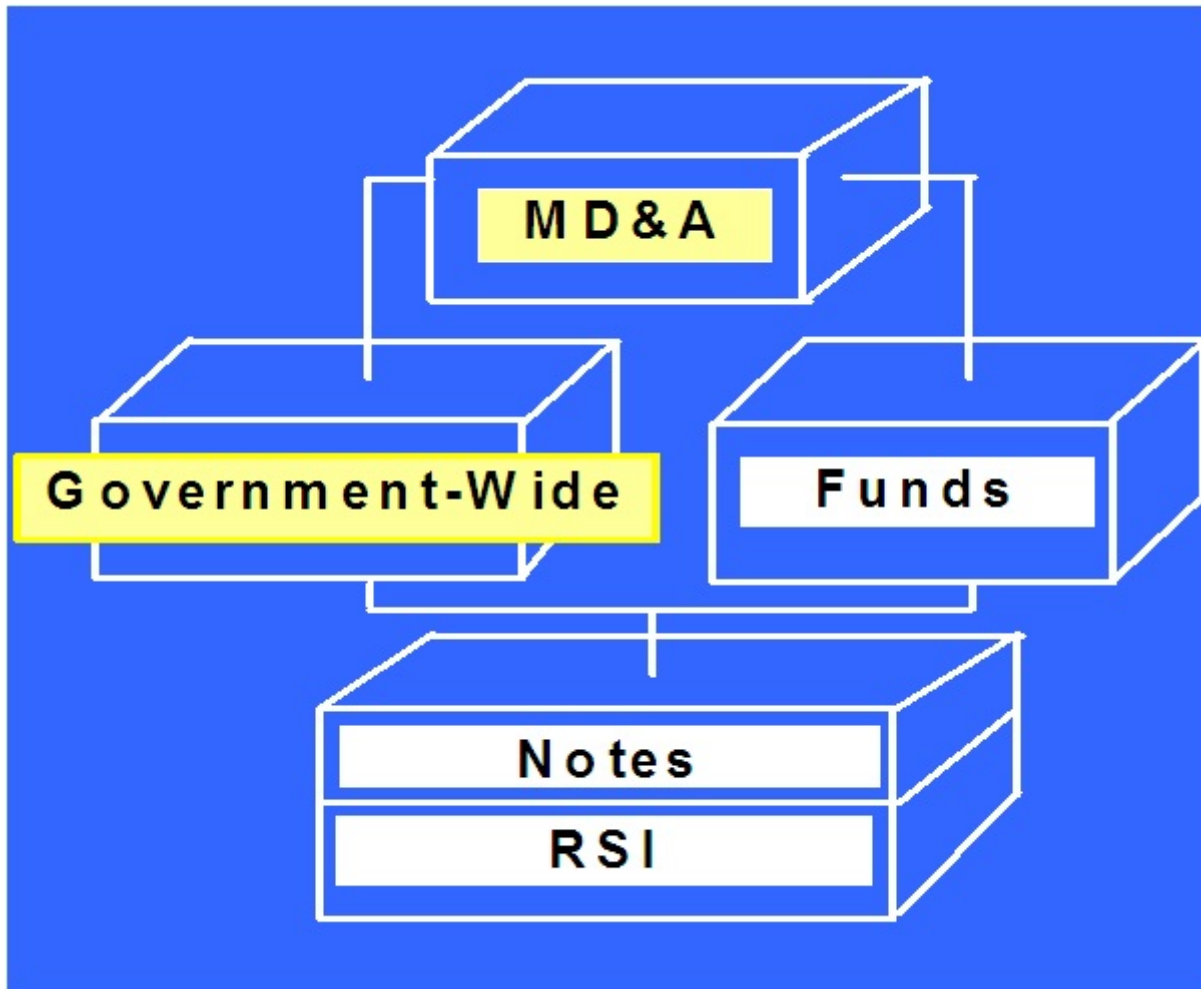
**Note:** The Louisiana Municipal Association is indebted to the Louisiana Legislative Auditor's office for the revisions to this chapter.

### FINANCIAL ACCOUNTING AND REPORTING

Unlike private-sector accounting, governmental accounting is oriented toward control of tax dollars, not identifying income produced. Governmental accounting utilizes fund accounting with each fund operating as a unique self-balancing set of accounts. Since there is no true net worth, the "leftover" amount of revenues after deducting expenditures is referred to as the fund balance.

There are three bases of accounting: cash (not permitted in the municipality), accrual, and modified accrual. For the most part, funds are recorded according to the modified accrual basis in which revenues are recorded only when actually received while expenditures are recorded as soon as the liability is incurred. This approach reflects the ultra-conservative nature of fund accounting. The government-wide financial statements are prepared using accrual accounting.

In 1999, the Governmental Accounting Standards Board (GASB) issued GASB Standard Number 34, which revamped the reporting model for governmental entities. The following graphic shows how the components of the reporting model for governments are interrelated.



MD&A—Management Discussion and Analysis  
Government-Wide—Government-Wide Financial Statements  
RSI—Required Supplemental Information

Examples of some financial statements required in Louisiana are provided in the budgeting chapter of the GAAFR guide.

An important consideration in the reporting is what local entities should be included in the financial statement. Statement No. 3 issued by the National Committee on Governmental Accounting addresses this question. The guidelines require the financial statement to include these entities subject to "oversight responsibility" by elected officials.

The criteria to test for such responsibility include:

Financial interdependence of entities. If the municipality approves the entity's budget or is morally obligated for the entity's debt, it probably should be reported in the municipal financial statements.

Selection of governing authority. If the municipality appoints the entity's board members, it implies oversight responsibility.

Management designation. If the municipality appoints the entity's employees or directs the entity's managers in day-to-day activities, it implies oversight.

Ability to influence fiscal matters or operations. If the municipality governs collection and disbursement of funds, control of facilities and contracts, and so on, oversight responsibility may be implied.

Service provided and to whom it is provided. To some degree, oversight depends on who benefits from the entity's service and what the scope of the service is.

The importance to municipalities is that the financial condition of special districts, special authorities, museums, libraries, industrial development corporations, and similar entities may have to be reported as part of the municipality's financial statements. Thus, the large debt of a special district would be reflected in the total debt of the municipality. You should consult a certified public accountant or the Legislative Auditor for guidance in this highly technical matter.

**Estimating and Controlling Expenditures.** In analyzing costs, classify them as fixed costs, those that tend to be indirect and uncontrollable, such as utilities and rent, or variable costs, those that tend to be direct and controllable, such as travel and equipment. This method will allow concentration on controllable items once uncontrollable items are excluded.

*"Red Flags."* Sometimes "red flags" arise over expenditures. Some warning signs of expenditure problems include:

Increasing excesses of current expenditures over current local revenues.

Increasing expenditures per capita in excess of the rate of inflation.

Increasing excesses of current expenditures over total revenues.

Increasing incidence of actual expenditures in excess of budgeted amounts.

Continuing increases in amount of unfunded portions of pension programs.

*Internal Control Methods.* Internal control in the accounting system is important to provide safeguards against theft, adherence to public policy, and operational efficiency. Numerous technical guidelines exist for internal control. However, some general guidelines are listed below:

Employ competent and trustworthy personnel and provide them with clear and distinct lines of authority and responsibility.

Provide for adequate division of duties such as separating authorization forms from the custody of assets and separating custody of assets from recordkeeping. (*This may not be feasible for very small offices.*)

Establish written authorization procedures.

Provide adequate documentation and records.

Establish clearly defined record keeping procedures.

Establish physical control procedures for records (such as filing and storage).

Provide adequate financial reporting.

Perform independent performance checks on accounting employees.

**Auditing.** The municipal clerk will be involved in the auditing process, even though a professional auditor probably will perform the actual examination of books.

*Categories of Auditing.* An audit can be performed in any one of three categories – financial, compliance, or operational – or any combination thereof. Generally, audits conducted for local governments are a combination financial/compliance audit. The main concern is that the financial statements be fairly stated in conformance with GAAP and that all applicable state and federal statutes have been satisfied.

- a. **Financial Auditing.** A financial audit is an examination by an independent auditor conducted in accordance with generally accepted auditing standards in an effort to express an opinion on an agency's financial statement as to their fair presentation in accordance with generally accepted accounting principles applied on a consistently applied [R.S. 24:514].

Some of the auditor's procedures include a review of internal accounting and administrative controls, a review of accounting methods and forms, comparisons of accounting records to the annual financial report, a test of transactions, a test of account balances, confirmation of balances with outside parties, observation of the annual inventory counts, a review of fixed asset records and physical inspections, and so on.

A timely annual financial statement that conforms with generally accepted reporting standards is essential for the auditor to express an unqualified opinion on the financial statements.

- b. **Compliance Auditing.** Compliance auditing is a review of the accounting structure, agency functions, transactions, and so on, and a comparison of such with applicable federal laws and regulations, state statutes, and local ordinances, regulations, and policies established by governing authorities, attorney general's opinions, contractual agreements, and the like. A lack of compliance with any of the above may cause the auditor to comment in his audit report or management letter.
- c. **Operational Auditing.** An operational audit is a review of any program or operating procedure to determine efficiency and effectiveness. Establishing criteria for judging efficiency and effectiveness is very subjective. Therefore, the main concern is making recommendations to improve program or service performance. For example, the audit may involve a review of the management of personnel, property, space, or some particular program.

*Preparing for the Audit.* Louisiana Revised Statute 24:513 and 24:514 require municipalities to engage a CPA to perform the following:

annual audit if revenues are >\$500,000

review/attestation if revenues are >\$200,000 and <\$500,000

or compilation if revenues are >\$50,000 and <\$200,000

Sworn annual financial statements can be presented if revenues are < \$50,000.

All audits must be conducted in accordance with generally accepted governmental auditing standards and—the *Louisiana Governmental Audit* [R.S. 24:513(5)(a)(i)].

Title 24 of the *Louisiana Revised Statutes* provides that the auditor may call on public officials and employees for advice and assistance and that such assistance shall be given through the assignment of personnel or in such other manner as necessities require. Adequate work space and other accommodations are necessary to commence the examination.

As anticipated in Title 24, the auditor will need to examine certain documents and records. One primary item is the annual financial report required by Section 514 of Title

24 to be completed within 60 days after the close of the fiscal year. Other items the auditor may want to examine include:

- Copies of each tax levy and budget and any adopted amendment(s).
- Copies of the minutes of all board and committee meetings and copies of the financial statements prepared by the management.
- An organizational chart including current names of persons in each position.
- A copy of the document flow chart. The auditor will want to trace the complete history of a transaction from how it was begun to its final disposition. Also, provide the auditor with copies of all accounting policies and procedures, including any current changes along with the effective date of all changes.
- Monthly bank reconciliations for each bank account, including all cancelled checks and bank statements through the date of the audit.
- A list of depositories and their addresses, including bank-account numbers and names of each depository and authorized signatures.
- A schedule of investment transactions by fund for the year.
- An insurance schedule, including names of companies, types of coverage, coverage dates, and total cost per policy.
- A reconciliation of control accounts (receivables, payables, and so on) to their subsidiaries.
- Details of any new bond issues approved, significant contracts, and lease agreements.
- A copy of any audits prepared by internal audit staff or external audit organizations.
- A reconciliation of cancelled bonds and interest coupons to paying agent accounts.
- A list of fixed assets owned by the auditee.
- Copies of legal publications.
- A summary of all litigation involving the auditee, such as summary to include administrative evaluation. This should be prepared as soon as possible after the close of the fiscal year and be confirmed by the auditee's legal counsel.
- Copies of any program flow charts and overview flow charts, if the auditee is

using data processing equipment for accounting functions.

- Copies of all lease agreements involving equipment and facilities.
- A schedule of all inter-fund loans or advances listing dates authorized, descriptions of transactions, and amounts and dates repaid.
- A schedule of all reports required by the governing authority and governmental agencies.
- An analysis of computer service operations. *(Should the auditee utilize data processing services provided by a service bureau, arrangements should be made with the service center to provide a "third party review" of the center's operations for use by the auditors. Should the service bureau not provide this, arrangements should be made with the center for the district auditor to perform this function.)*
- Access to paid invoices, purchase orders, and receiving reports.
- A listing of all funds and accounts managed by the auditee.
- A listing of all council members and their addresses.
- A letter of representation from the chief executive officer concerning various areas of fiscal management.
- Other material as may be requested by the auditor.

*The Audit Process.* The following are considered normal steps in the auditing process.

- Review by the auditor of an agency's system of internal controls to determine to what degree these controls can be relied upon and to make recommendations to management regarding better safeguarding of assets and operations.
- Based on the system of controls and relative risk, the auditor will apply certain audit tests applicable to a financial and compliance audit.
- At the end of the audit, the auditor, by means of an exit conference, will discuss with the auditee areas of concern, matters for clarification, and any unresolved matters. The exit conference provides an auditee the opportunity to clarify misunderstandings, provide additional documentation, receive the views of the auditor, and receive necessary input to develop plans to improve the agency's operations.
- Material items of a financial or noncompliance nature are developed and

included in the audit report.

*Contents of the Audit Report.* In every audit report, the auditor must express an opinion as to the fair presentation of the financial statements. His or her opinion may take the following form:

- Unqualified (no problems found)
- Qualified (a relatively few minor problems found)
- Disclaimer (no opinion, as in the case when books are too unorganized to audit)
- Adverse (major problems are found)

Immediately following the auditor's opinion will be comments on any matters of non-compliance. These comments are constructive in nature to provide the auditee guidance in future transactions.

*Resources on the Internet.* The following is a list of websites with additional information.

**Governmental Accounting Standards Board (GASB)**

[www.gasb.org](http://www.gasb.org)

**Louisiana Legislative Auditor**

[www.lla.state.la.us](http://www.lla.state.la.us)

**Association of Government Accountants**

[www.agacgfm.org](http://www.agacgfm.org)

**Government Finance Officers Association (GFOA)**

[www.gfoa.org](http://www.gfoa.org)

**Louisiana Society of Certified Public Accountants**

[www.lcpa.org](http://www.lcpa.org)

**National Association of State Comptrollers**

[www.nasact.org](http://www.nasact.org)

**National Federation of Municipal Analysts**

[www.nfma.org](http://www.nfma.org)