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## Audit Procedure and Books of Account in Small Municipalities

BY ROY C. BROWN

The professional accountant who is first called in to audit the records of a small municipality is in nearly every case confronted with a situation involving inadequacy of records, commingling of funds, and a multiplicity of minor inaccuracies. In some instances he will find that no attempt has been made to keep books and that the only records available are the tax rolls, minute book, police docket, stubs or carbon copies of the various classes of tax receipts and statements from banks of deposit with canceled warrants or cheques.

Such a situation is far from hopeless. From the viewpoint of the accountant and excepting the failure of municipal authorities to maintain such records as the law may specifically provide, it is a better condition than the presence of a misfit set of books, the product of the limited ability and knowledge of some local bookkeeper.

One of the first advisable steps is a consultation with the attorney for the municipality. If the attorney is convinced of the helpful intentions and knowledge and professional standing of the accountant, he is likely to divulge in confidence a wealth of useful information as to the personal characteristics of the mayor and aldermen and of the local taxpayers and an informal history of past performances which will be of the greatest assistance in interpreting the facts behind the figures which the accountant will presently examine and compile. The accountant should also at this time take notes of any specific statutory requirements as to the duties of municipal officers, books of record to be kept, how special meetings are to be arranged, limits to bonded indebtedness, limitations as to assessments of taxes for specific purposes, as to fund deposits and depositaries, and application of funds.

Equipped with this valuable information the actual audit procedure can now be intelligently commenced. The first advisable step is to foot the tax rolls to ascertain whether or not the total is in agreement with the amount shown by the minutes of the regular meeting at which the rolls were accepted, and the tax rates, expressed in mills, for each specific purpose authorized. The reconciled total, plus subsequent upward revisions and minus downward revisions as shown by the minutes, multiplied by the total mills, should give a result in agreement with a tape taken from copies of the tax receipts, although such an agreement will usually be found lacking. The deposits of tax money made to the various fund accounts, plus original receipts not delivered to delinquent taxpayers, should agree with the total taxes due to be collected, and the original receipts on hand will afford a schedule of taxpayers who are delinquent.

A very rough proof of the street-tax collections can be made by multiplying the number of qualified voters by the rate per annum in dollars, but, on account of the age at which street tax first becomes due, usually 18 years, and the unfortunate fact that many citizens fail to qualify to exercise the franchise, no significance can be attached to an overrun of the deposits. A smaller collection than the proof figure should be investigated.

Deposits of fines should be proved by inspecting the police docket. Privilege taxes are difficult to prove without a physical checking of the business houses and industries, which is hardly practicable. However, the accountant can usually learn in conversation whether any tent shows or circuses have visited the town in the recent past, and if no stubs are in evidence to show the collection for privilege licence from such visitors an inquiry should be made.

Bank balances should be verified and the bank accounts reconciled as in any audit. Warrants should be compared with the minutes of council to ascertain that all payments have been properly authorized and the authorizations made a matter of record. Invoices against which the warrants have been issued should be called for and examined for approvals and certifications as to receipt, correctness of quantities billed and satisfactory condition and quality of any material received.

Ordinances authorizing sidewalk construction should be particularly examined and a comparison should be made between the bills and the authorized construction. The collection of the

proportion of the expense to be borne by taxpayers directly benefited should be verified.

Bond issues should be traced to the original authorizations. Canceled bonds and coupons or records of their destruction by council at regular or special meetings should be examined and checked against a schedule prepared by the accountant, showing the maturities of bonds and coupons, in order to determine the amount of bonds and coupons that have matured but have not been presented for payment, and this amount should be reconciled with the balances in special bond-redemption accounts in the possession of banks or trustees designated to pay maturing bonds and coupons on presentation.

Realizations from the sale of bonds should be verified, and, with the application of the bond funds, should be made the subject of a schedule for each bond issue.

If the town owns and operates a light or water plant, the actual construction cost will have been verified in the comparison of the warrants with the minutes. Contracts for work in the erection of the plant, construction of the distribution system and installation of the machinery should also be examined and the accountant should at least visit the plant and verify the installation of engines, electrical machinery, pumps, tanks, etc. Care should be taken to ascertain that insurance coverage in the form of fire, tornado, employers' and public liability and electrical-machinery policies have been provided and are on file, as well as steam-boiler insurance if the plant has one or more steam boilers in the equipment. The machinery houses should be circularized to learn whether vendors' liens exist on any of the machinery or not.

The existence of a good light and water register divided according to sections of the city, as is the tax roll, showing where revenue is due to be collected and the names of consumers in arrears will rarely be found. Designing and installing such a register will be one of the accountant's most valuable services. An ordinary columnar book can be used to advantage. Only one section should be listed in each block of five lines, and four columns to the month may be used conveniently, the first to record current and previous meter readings, the second to extend the amount due for light and power, the third for the amount due for water, and the fourth to record the date when each account is paid.

Surety bonds should be called for and inspected, and if recent inventories of miscellaneous equipment such as fire hose, hose

carts, wagons, harness, live stock, tractors, road machinery, sprinkler wagons, etc., are not available the accountant should request that an inventory be made, in order that such assets may be properly valued and listed on the books of account.

When the work has progressed to this point, it becomes necessary to consider what books of account should be installed to prepare a workable chart of accounts, and to begin the preparation of a report for presentation to the board of mayor and aldermen. The following books will usually be found sufficient:

1. Collection register (columnar stock form).
2. Warrant register (columnar stock form).
3. Light and water register (columnar stock form).
4. General journal (stock form).
5. General ledger (stock form).

No provision is made for a payroll book, as each department will carry stock-form time books if the number of employees warrants it.

In the preparation of a chart of accounts nice discriminations must be observed, in order that the designated accounts may accord with good practice and at the same time be not so technical as to confuse the people interested. The average small-town taxpayer takes a much more active interest in the affairs of his municipality than a resident of a larger community, where interest is apt to be casual and perfunctory if it exists at all. The accounts and distribution system must be readily comprehensible to the clerk, who often devotes only a part of his time to the affairs of the town, and statements drawn from the books must be readily understandable to the board of mayor and aldermen and to taxpayers who may, and many of whom will, care to inspect the record.

Such terminology as "budget requirements", "special revenue requirements", "construction requirements", "reserve for capital claims", etc., will be Greek to the ordinary citizen, and he will usually be outspoken in disapproval of the employment of such language in the description of the affairs of his municipality, about which he very properly feels that he is entitled to information which he can understand at a glance. Bearing this in mind, the following classification is suggested as a practical one, subject to revision to meet local conditions.

*Municipal Audit Procedure and Books of Account*

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*Assets*

Current assets:

101. General fund (bank account).
102. Street fund (bank account).
103. Light and water fund (bank account).
104. Taxes receivable, current year.
105. Taxes receivable, previous years.
106. Light and water accounts receivable.
107. Special assessments receivable, current year.
108. Special assessments receivable, previous years.
120. Other current items.

Parks and public buildings:

201. Town hall and jail, including sites.
202. Parks and pavilions.

Streets, driveways, sidewalks, and sewers:

301. Paved streets, concrete.
302. Paved streets, brick.
303. Paved streets, bitulithic and other construction.
304. Sidewalks, concrete.
305. Sidewalks, brick.
306. Sidewalks, other construction.
307. Sanitary sewerage system.

Public utility, income producing:

401. Light and water plant buildings and sites.
402. Engines.
403. Electrical machinery.
404. Pumps.
405. Boilers.
406. Fuel storage tanks.
407. Fuel storage bins.
408. Water tanks and towers.
409. Artesian wells.
410. Light and power distribution system, poles, wires, etc.
411. Meters, electric.
412. Water mains.
413. Water lines.
414. Meters, water.

Other properties:

501. Hose carts and fire apparatus.
502. Fire hose.

- 503. Sprinkler wagons.
- 504. Trash and other wagons and carts.
- 505. Work animals.
- 506. Fire and hose-cart houses.
- 507. Tractors.
- 508. Road-working machinery.
- 509. Office furniture and equipment.
- 520. Miscellaneous equipment.

Bond and special funds:

List unexpended balances in each bond fund or special fund, only available for definite construction projects, prefixing each account with a number, beginning with 601.

Current liabilities: *Liabilities*

- 801. Salaries payable.
- 802. Payrolls payable.
- 803. Accounts payable, approved.
- 804. Notes payable.
- 805. Current maturities, bonds and coupons.
- 806. Claims admitted, tax refunds and damages.
- 807. Judgments payable.
- 820. Other current items.

Bonded indebtedness:

List each outstanding issue, prefixing the first item 1001 and so on.

Surplus:

- 1101. Current surplus, excess of current assets over current liabilities.
- 1102. Capital surplus, excess of other assets over bonded indebtedness.

*Revenues*

- 1201. Taxes, general levy.
- 1202. Taxes, bond and coupon levy.
- 1203. Privilege licences.
- 1204. Street taxes.
- 1205. Fines and costs.
- 1206. County settlements.
- 1207. Sales, light and power.
- 1208. Sales, water.
- 1220. Miscellaneous.

*Expenses*

- 1301. Salaries, mayor and clerk.
- 1302. Stationery and office supplies.
- 1303. Telephone and telegraph.
- 1304. Rent.
- 1305. Heat, light, janitor.
- 1306. Salary, marshal and watchmen.
- 1307. Sprinkling and cleaning streets, labor.
- 1308. Sprinkling and cleaning streets, material.
- 1309. Repairs, streets, sewers and sidewalks.
- 1310. Light and water plant, salary of superintendent.
- 1311. " " " " wages.
- 1312. " " " " fuel.
- 1313. " " " " lubricating oil.
- 1314. " " " " repairs machinery.
- 1315. " " " " repairs structures.
- 1316. " " " " repairs transmission lines, electric.
- 1317. " " " " repairs mains.
- 1318. " " " " repairs water lines.
- 1319. " " " " supplies.
- 1320. " " " " insurance.
- 1321. " " " " miscellaneous.
- 1330. Personal injuries.
- 1331. Taxes refunded.
- 1332. Interest, notes payable.
- 1333. Interest, bond coupons.
- 1334. Fire and storm damage.
- 1335. Charitable expenditures.
- 1350. Miscellaneous.

The preparation of the report, especially the first report which will excite unusual interest, curiosity and comment, calls for tactful treatment. Errors of omission and commission should be commented on, but with care to avoid severity in treatment. The advantages of preparing an annual budget and operating within its limits should be emphasized. The balance-sheet should be explained, item by item, as in a commercial audit. The complimentary closing should be cordial, but care should be taken not to overdo this, as excessive cordiality may easily strike a note of insincerity.



Suggested exhibits and schedules to accompany the report are:

- Exhibit "A." Balance-sheet.
- Exhibit "B." Cash receipts and disbursements.
- Exhibit "C." Bond-fund expenditures.
- Exhibit "D." Light and water operating statement.
- Schedule 1. Delinquent taxes.
  - " 2. Delinquent light and water accounts.
  - " 3. Public-utility properties, income producing.
  - " 4. Salaries payable.
  - " 5. Accounts payable.
  - " 6. Notes payable.
  - " 7. Bonded indebtedness.
  - " 8. Reconciliation current surplus.
  - " 9. Reconciliation capital surplus.

Auditing small-town records is a very unfruitful field for specialization. The fees are usually meager, working conditions poor and the work is laborious in the extreme. Nevertheless, there is an increasing tendency for legislatures to require publication of annual balance-sheets and statements of receipts and disbursements by towns of 1,000 population and over, and it is one of the conditions that the profession must meet unselfishly and with convincing thoroughness. If there are any rewards to be expected they will be in the form of goodwill and such accretions to practices as may result from the formation of new friendships and acquaintances. In the hope that the subject matter may be in some small way helpful, this article has been prepared and offered for publication in *THE JOURNAL OF ACCOUNTANCY*.

The undeniable factor of depreciation of the properties has purposely been left untouched in the article. The good judgment of the accountant will enable him to determine whether it is practicable to recognize depreciation on the books of account or preferable to ignore it. The question has been the subject of much controversy, with the proponents of bringing depreciation on the books usually having quite the better of the argument. It is sufficient to say that occasionally a stone wall will be found most illogically placed and no arguments, however sound, or theories, however tenable, will move it.