Municipal Accounts—Their Preparation and Audit

George Rea

Follow this and additional works at: https://egrove.olemiss.edu/jofa

Part of the Accounting Commons

Recommended Citation
Available at: https://egrove.olemiss.edu/jofa/vol29/iss3/1

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Journal of Accountancy by an authorized editor of eGrove. For more information, please contact egrove@olemiss.edu.
Municipal Accounts—Their Preparation and Audit*

BY GEORGE REA

Nothwithstanding the regulations and restrictions surrounding municipal affairs, up-to-date accounting methods may be employed as readily as in private business. These regulations will be found to be matters of administration more often than of accounting, dealing with the transactions rather than with the records.

He who undertakes to prepare a system of accounts for a municipality or to audit them must be thoroughly familiar with all the laws governing its financial transactions. These laws are found in the statutes, in the charter under which the municipality is organized (whether it be general or special) and in its ordinances. Many regulations are most annoying because of an overreaching and unintelligent effort to safeguard the city's money. But a careful survey will enable the accountant to provide a simple and efficient system of accounts and at the same time to meet the legal requirements.

A literal interpretation of all the laws affecting accounts would require a vast amount of duplication of records. Too often the statutes are the heritage of olden days when the transactions were few and modern business methods were not known. In one state laws are yet in effect which were enacted when the treasurer honored warrants by paying cash. Although later laws have been passed permitting him to deposit the city's money in bank, the original acts remain in force requiring him to keep records duplicating those of the city clerk.

In this paper more particular attention is paid to the require-

* A thesis presented at the November, 1919, examinations of the American Institute of Accountants.
ments of small municipalities. The same principles would be applied in the largest cities, the records being adapted to the larger volume of business.

Practical independence is sometimes granted to certain boards and commissions, which will cause endless confusion if they are allowed to exercise their privileges without limit. Arrangements should be made to have their financial transactions recorded in the city accounts.

**Records**

In a small municipality the clerk may be the bookkeeper. In a large city the comptroller's department is the accounting department. Between these extremes the books should be kept by one or more deputies under the direction of the city clerk. In all cases some person should be made responsible for the accuracy and completeness of the general accounts and should verify the accounts of deputies and officers handling money and keeping department records.

In the general ledger the accounts should be grouped in the usual classes—assets, liabilities, expenses and income, arranged in each class in a logical order. Expenses should be subdivided by departments. A numerical system of designating accounts can be employed with advantage. It should be arranged to permit new and special accounts to be opened in each class and subdivision, maintaining unity and logical order.

The form of cashbook will depend upon the methods employed in handling receipts. In a small town where the clerk is de facto collector of taxes, licenses, fees, water bills, etc., a column should be provided for each class of income. In larger cities each department should keep a cashbook and make periodical settlements, a summary of the transactions in each period being entered in the general records as a charge to the treasurer. In this case the clerk's cashbook need not be so elaborate, as the entries will be comparatively few.

Absolute control should be maintained over every officer receiving cash by requiring him to issue a carbon duplicate receipt. Licenses and permits at predetermined rates may be made self-recording receipts by providing them with stubs similar to those on post-office money orders. The clerk or a deputy should verify
Municipal Accounts—Their Preparation and Audit

each department’s collections from the amounts shown on the duplicate receipts or stubs.

A municipality’s money is divided into funds, from each of which only certain classes of expenditures may be made. This is intended to limit the expenditures in each class, but it is nullified by the power granted to the governing body to transfer money from one fund to another at will. These funds are in effect several bank accounts. Corresponding accounts should be opened in the general ledger, and provision should be made in the cashbook to determine readily what moneys are to be deposited in each fund.

Distribution of receipts to the several funds is determined by the tax levy and ordinances. With taxes this is generally so involved a process as to forbid the distribution of each item. If only one depository is maintained and the clerk keeps a complete cash record, one distribution may be made of the month’s total collections; or the clerk may deposit in a special account which will be transferred to the treasurer at the end of the month. If funds are low and demands are pressing, the distribution may be made more often.

While designated by other names, the instruments employed in municipal transactions are the same as those in private business. Demands or claims are purchase and expense invoices. Warrants are cheques on the depository banks or drafts on the treasurer.

Claims should be approved by the purchasing department, if there be one, or by the head of the department incurring the expense, and sent immediately to the accounting department to be recorded. The claims register may be used as a distribution record by providing double columns (for name or number of the account and amount) for each department and for sundry expense. At the end of the month the charges in each column may be summarized and totals of each account may be posted to the ledger. In another column should be entered the number of the warrant drawn in payment of each claim.

The monthly total of the claims is credited to claims payable account, against which are debited the warrants drawn. Thus the claim and claims register correspond respectively to voucher and voucher record. As many municipalities require claims to
be filed on the city's forms, duplicate claims may be used with all the advantages of the duplicate voucher system.

In the warrant register a column should be provided for each fund (funds with infrequent transactions may be handled through a sundry column) corresponding to the several bank columns in the cheque register, a debit column for the charge to claims payable and a column for claim numbers. If discounts are not deducted when the claims are entered, a discount column also is needed. The balances in bank or in the treasurer's hands should be reconciled in the same manner as a bank account.

The accounts should be kept on an income and expense basis. Unless the city is so fortunate as to be able to pay all expenses incurred, a condition which circumstances may alter at any time, receipts and disbursements accounts cannot give the information needed to manage the city's affairs efficiently. Therefore, the claims register should be held open until all the month's expenses are recorded, claims of the following month being entered on another page.

But these records will not accumulate the data for reports which some state comptrollers require to be made on a receipts and disbursements basis. If such a report is required, a second record should be provided similar to the claims register, in which the segregation of expense accounts will be made from the disbursements. It should be understood that this record is for a special purpose and is not to be confused with the regular books of account.

It is suggested that accountants who have municipal clients urge the state officers to permit reports to be prepared on an accrual basis.

The ordinary two-column journal usually will be found adequate for most municipalities.

The records to be kept by the treasurer will depend upon the methods employed in handling the city's funds. The clerk's records should be so kept that the balance in each fund may be known at any time; and no warrant should be drawn if there is not a sufficient balance to pay it. No special record then need be kept by the treasurer if the money is deposited in banks. But if warrants be drawn regardless of the condition of the funds, the treasurer must keep complete records of all deposits and with-
drawals, that he may know when a fund is depleted and refuse payment on warrants drawn thereon.

**Income**

The income of a municipality is derived principally from taxes. The records and procedure for levying and collecting them are prescribed by law. As seventy-five per cent or more of each levy is collected in the few days immediately preceding the delinquent date, numerous errors result from the volume of work handled in a brief period—and usually with inadequate records.

Within the limits allowed by the statutes, the tax roll should be prepared so that each taxpayer and each piece of property can be located readily and the amount of taxes determined at a glance and not be confused with other items. Space should be provided for the date, number of receipt issued and amount of tax paid. The roll thus may be used as a subsidiary ledger, with a control account in the general ledger. If the roll is large, it should be subdivided into two or more sections, alphabetically or geographically, with corresponding control accounts in the general ledger and columns in the cashbook.

The tax roll should be reconciled with the control accounts as carefully as any subsidiary ledger. The word "reconciled" is used instead of "balanced," as errors will occur in the collection of taxes. Overages should be refunded and shortages collected. The latter is not impracticable, even for small amounts, as an unpaid portion of the tax is as much a lien on the property as the whole assessment.

The method of handling receipts from licenses and permits has been described in relation to the cashbook.

If the city owns its waterworks or other public utility for which a charge based on the service rendered is made, an accounts receivable ledger should be provided with a control account in the general ledger. Postings should be made from the meter or other service record. The bills should be made from the same record independently of the ledger postings. Adding machine lists of the bills and of the postings should be compared to detect and correct errors. A special column should be provided in the cashbook for each service ledger.
Expenses

As suggested in the description of the general ledger, the accounts should show the expense of each department. The extent to which they are subdivided will be determined by the volume of business, by the importance of the work of each department and by the wishes of the governing body and of the department heads. The general subdivisions of salaries, wages, office supplies and expenses, department operating supplies and expenses, repairs and special expenses are suggested. Any one may be further divided as desired.

General administration expenses may be treated as a separate department. Among its special expenses will be interest on the bonded debt.

Capital expenditures should be carefully segregated from operating expenses. Perpetual inventories should be maintained, as the property and equipment are distributed among many persons, who are required by statute to account for them but seldom do so systematically and satisfactorily.

Bonded Debt

In the case of bonded debt the initial entry will be a cashbook credit of the par value of the bonds to bonded debt account and another credit to premium on bonds sold. If they are sold at a discount a journal entry charging discount and crediting bonds is needed to complete the record. When a bond is redeemed, its par value should be charged to the bonded debt account, premium or discount if any being charged or credited to the revenue account.

A liability for interest on bonded debt should be set up by journal entry on the date when the interest is payable, and coupons as paid should be charged to this account.

If the city's money is deposited, arrangements should be made with the banks not to charge maturing bonds and coupons against the balance on hand, but to present them to the clerk, that a claim and warrant may be recorded. Unless this is done, not only will the clerk be unable to show in his records the exact balance, but the record of payment of bonds and coupons will be deficient and probably impossible of later verification.
Municipal Accounts—Their Preparation and Audit

Reports

If the accounts in the general ledger are properly classified and arranged, a trial balance can be taken in the form of a monthly report. Often the only additional data required will be the total receipts and disbursements in each fund, the tax collections and the increase in each revenue account to show the income and expenses of the month.

Audit

Under existing conditions in municipal government, it is reasonable for the accountant to assume that there is no adequate check on the transactions, and that he can be more than ordinarily suspicious of the records he is about to examine. Or to state it more conservatively, he cannot accept a transaction as regular because it would be such in private business. The officers feel so handicapped by their restrictions that they constantly seek methods to evade them. Many municipal audits are authorized solely for the purpose of having an auditor's report to which an appeal may be made in case an officer's record is attacked. The necessity for an accountant to be absolutely sure of his position in a municipal audit cannot be emphasized too strongly.

The computation of taxes and the footings of the tax roll can be proven by multiplying the total assessed valuation by the tax rate, the product equaling the total taxes. Compensating errors may be detected by making a like computation at every fifth or tenth page, or each page may be proven if an absolute verification is desired. Fractions will cause small differences in the footing of each page, but may be disregarded unless they exceed an amount previously determined as an allowable difference.

The accountant, of course, will refer to the ordinance or resolution levying the tax to see that the proper rate has been applied and will note also that it is within the statutory or charter limit.

The cash collected, less penalties, plus the delinquent taxes must equal the original roll. The delinquent roll must include also penalties and costs. The accountant will be fortunate who has not to check all transactions, for the methods employed produce errors and many adjustments may be required. If a complete check is not to be made, a thorough test should be given, having in mind the possibility that a forced balance or reconciliation has been made by the collector.
The Journal of Accountancy

The allocation of the cash to the several funds, as set forth in the ordinance, must be verified.

Redemption of delinquent taxes presents its own problem, varying with the community. The amount of the tax originally assessed and the penalties and the costs, as stated in the certificate of redemption, must be compared with the corresponding items in the delinquent roll.

Interest and penalties often are cumulative. The rates must be those prescribed by statute or ordinance. Computations should be tested thoroughly and all should be verified if many errors are found. A careful investigation must be made of the method of recording redemption in the delinquent rolls. If the ledger does not contain a control account for each tax year, it may be necessary to go through all the rolls to determine if all redemptions have been included.

Delinquent taxes being a part of the income provided for previous years, the receipts from their redemption must be applied to the liquidation of unpaid expenses of those years, if any exist, before they can be applied to current expenses.

For franchise taxes based on the gross income of a public utility there probably will be found the corporation's statement. If this can be compared with published reports, or access can be obtained to the financial statement usually available to bankers and brokers, such comparison should be made.

When examining the income from licenses and permits, it is not enough merely to account for the fee. Officers often content themselves with issuing these documents as application is made for them, instead of compelling all licensees to renew their privileges at the stated periods. Annual licenses issued during the year may be compared with those of the previous year. Quarterly and monthly licenses may be tabulated. Omissions should be investigated carefully. The fee for each class of license and permit should be compared with the ordinance.

If it is specified that receipts from a particular source of income or any part thereof shall be available for certain expenditures, it must be seen that such receipts have been deposited in the proper funds.

Miscellaneous income must be treated similarly, the exact method depending upon its nature and source.
Municipal Accounts—Their Preparation and Audit

A source of income frequently overlooked is interest on deposits, both ordinary and special. In some states banks are required to pay interest on daily balances under a penalty against both banker and treasurer.

Transfers of funds may be made by warrant or by journal entry. In either event the only matter of interest to the accountant is that each transfer shall have been duly authorized.

In the examination of claims, the questions to be answered are these: Have they been approved by the proper authorities? Are they proper expenditures from the funds from which they were paid (this is even more important than the question whether or not the warrant was drawn on the fund specified on the claim)? Was the expense incurred within the year in which this fund received its income?

Another point worthy of attention is the amount of the claim. Some charters fix a limit beyond which a purchase can be made or an expense incurred only by action of the council after due advertisement. Many ingenious methods are employed to nullify this regulation. In a city allowing a maximum of five hundred dollars, the purchasing department placed a standing order for daily delivery of cement over a period of weeks and arranged with the seller to render bills in amounts of five hundred dollars each. These bills were duly passed by the construction and purchasing departments, approved by the council and a warrant for five hundred dollars was drawn for each.

In addition to examining the warrants in the verification of the treasurer's balance, each must be compared with the claim which it pays to see that the amount is correct and that it is drawn on the proper fund.

The utmost care must be taken to detect double payment of bonds and coupons. If the officers and deputies are not careful in handling these, they may fall into unauthorized hands and be presented for payment a second time. If each bond and coupon can be identified from the record of its payment, all should be checked in detail and payment of an item maturing in a previous year should be investigated until the accountant is assured that the transaction is regular. If there is no identifying record, the total interest and principal payments on each series of bonds and the unpaid matured items must be determined and then be com-
pared with the liability accruing for the year. Should a discrepancy exist, like details for one or more preceding years must be determined, until a reasonable reconciliation is obtained. But in his report the accountant must be careful to show the inadequacy of records which do not identify every payment of money.

Special assessments for lighting, sewers, paving, etc., must be treated as the ordinances and circumstances may determine. In some cases these funds are handled by the treasurer or other officer in a trust capacity, and the cities have no direct control over them. Should their examination not be included in the accountant's engagement, he nevertheless should satisfy himself when verifying the regular municipal funds that the trust funds were not employed to cover shortages.

In conclusion it may be stated that a reasonable assurance of the accuracy and completeness of municipal accounts amounts almost to what would be an absolute verification of a private business.