Model Accounting, Auditing, and Financial Reporting Policy + Guidance

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Accounting, Auditing, and Financial Reporting Policy Guidance

VLCT developed this model accounting, auditing, and financial reporting policy to help municipalities effectively manage government finances. Voters approve a budget and hold the municipal officers accountable for its proper management. If officials don't know how financial resources are being used, or whether they are being used to accomplish the voters' goals as represented in the budget, those officials have failed to fulfill their important role as stewards of public funds.

An accounting, auditing, and financial reporting policy sets the tone for fulfilling this stewardship role. Every town should aspire to establish and maintain high standards for its accounting practices. Such standards inspire confidence in the financial information that is produced and presented to voters. They enable the voters, selectboard, and other officials to make sound decisions in preparing and adopting the town budget and managing town finances.

The following should be considered in the development of an accounting, auditing, and financial reporting policy:

Accounting Standards. Vermont statutes provide no legal standard for municipal government accounting. Unfortunately, the lack of a common standard has resulted in a wide variation in accounting practices among Vermont municipalities. For municipalities seeking to standardize their accounting practices, the generally accepted accounting principles (GAAP) for local governments, established by the Governmental Accounting Standards Board (GASB) are a helpful guideline. GASB is the independent organization that establishes and improves standards of accounting and financial reporting for U.S. state and local governments. GASB is generally recognized by governments, the accounting industry, and capital markets as the

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official source of generally accepted accounting principles for state and local governments.

The generally accepted accounting principles for local governments promulgated by GASB can assist municipalities in providing officials and voters with financial statements that can be analyzed and compared from period to period. It also provides comparability across municipalities, something that cannot be accomplished now with the variety of reporting formats used throughout the state. There is also less room for error and fraud when specific uniform standards are applied to the accounting process. This adds up to better reporting, more accountability, and, one hopes, more informed and supportive voters.

Compliance with GAAP requires the establishment of a fund accounting system and measuring the financial position and results of operations using the modified accrual basis of accounting for governmental fund types and the accrual basis of accounting for proprietary and fiduciary fund types. For more information about GASB and GAAP for local government, please visit www.gasb.org.

Independent Auditing. Hundreds, if not thousands, of transactions are posted to town books each year, including complex payroll and benefits payments. While compliance with generally accepted accounting practices helps ensure that transactions are accurately booked and reported, mistakes and even fraud can still occur. Independent auditors can review the municipality's accounting system, along with the town's internal controls, and conduct field tests by taking transactions from a trial balance (listing all account balances including revenues, expenses, assets, and liabilities) and tracking down the source documents to be sure that everything has been processed properly and recorded correctly.

The purpose of this review is to determine if the financial statements are free of "material misstatement." In this regard, an independent auditor will offer an opinion on

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whether or not the financial statements fairly represent the true financial condition of the town. A management letter is also provided, reporting any material weaknesses in the accounting system – things the auditor considers important enough to be addressed and corrected, such as inadequate documentation of payments being processed or bank accounts not being reconciled. Other reportable conditions that are not deemed to be material are also listed in the management letter and may include items such as lack of an approval process for journal entries or inadequate documentation of accounting processes.

Vermont law requires that a town have auditors, whether appointed or elected. These officials are charged with examining the accounts of town officers and reporting their findings in writing to the voters through the annual town report. 24 V.S.A. §§ 1682, 1683. The amount of time auditors must give to perform their duties depends upon the size of the municipality and the complexity of its budget. The responsibilities of the office may exceed the capacity of local volunteers, and some municipalities have been unable to find persons willing to hold the office. In such instances, a town may vote to eliminate the office of auditor. 17 V.S.A. § 2651b. If the town does vote to eliminate the office, the selectboard must contract with a certified public accountant or public accountant licensed in this State to perform an annual audit of all town funds.

Even where local auditors have not been eliminated, it is a good practice for municipalities to have their financial statements regularly audited by an independent accounting firm. An outside auditor can be hired upon motion of the selectboard or vote of the town. 24 V.S.A. § 1690(a). In addition to determining whether the financial statements are fairly presented in accordance with GAAP, an outside audit will also review a town's procedures and internal controls for weaknesses or deficiencies and make recommendations for improvements. While it is helpful to have an independent audit prepared on an annual basis, such a service can be expensive and not every town can afford to have an audit every year. Accordingly, the policy should specify the frequency of the independent audit.

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Financial Reporting. In practice, Vermont local government typically follows a four-step

Financial management process centered on the annual town budget. The selectboard, usually with input from the town treasurer, undertake preparation of the proposed budget prior to the annual town meeting. The budget is adopted by the voters at the annual meeting and is managed through the fiscal year by the selectboard and other municipal officers having authority to draw orders on the treasurer. Finally, the auditors evaluate the performance of these officers and report this information back to the voters through the town report.

The selectboard carries out its responsibility to manage the town budget under its authority to approve orders for payment of town funds. 24 V.S.A. §§ 1576, 1621, 1622. In order to do so, the selectboard must have timely and accurate information about the status of the town's finances. The treasurer is obligated to keep accounts "of moneys paid out by him for the town," and such accounts "shall at all times be open to the inspection of persons interested." 24 V.S.A § 1571. The treasurer is also required to provide quarterly reports to the selectboard regarding these actions, and "annually on or before June 30th provide the selectboard the State Auditor of Accounts document regarding internal financial controls." 24 V.S.A. § 1571(c),(d).

Additional financial reports are important because they give the selectboard and other officials a snapshot of where the municipality stands financially at any given point in time. A Budget Report shows where the town stands in relation to its budget. It is a report of revenues collected and appropriations expended with a column for the variance in each line item – how much the town is either over or under what was budgeted. The Statement of Revenue, Expenditures, and Changes in Fund Balance details revenues and expenditures and shows the difference between the two – either a surplus if the town has more revenue than anticipated or a deficit if it has more expenditures. It shows the beginning fund balance and adds the surplus (or

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subtracts the deficit) to give the ending fund balance. The Balance Sheet shows the municipalities' assets, then looks at those assets in terms of the amount that is debt (liabilities) and the amount that is not debt (fund balance). The fund balance reflected on the Balance Sheet should match the ending fund balance from the Statement of Revenue, Expenditures, and Changes in Fund Balance.

The town's annual report should include financial statements prepared in conformance with GAAP reporting principles, as well as additional disclosures necessary for the complete understanding of the financial statements presented. The report should also include a narrative discussion to explain how the town's current financial position and results of operations compare with the prior year and with the budget (management discussion and analysis). It may also be helpful to provide statistical data over a ten-year period to provide a longer-term trend analysis of financial changes.

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