

LOCAL FINANCE NOTICE

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General Ledger Accounting Systems Technical Accounting Directive 86-3 Update

Introduction

On January 1, 1986 the Division of Local Government Services issued Technical Accounting Directive #3 requiring that all local units maintain a General Ledger Accounting System for the current fund in accordance with certain minimum standards. These standards shall be applicable for all funds of the local unit: current, state and federal grant, capital, all trusts and utilities.

Since the directive has been issued, the majority of local units have complied. However, a recent review of audits and Extraordinary Aid program applications has revealed that there are still local units that have not fully implemented this directive. This is of concern to the Division, since in the 17 years that the directive was established there have been many newly trained Chief Financial Officers and accountants. In addition, many vendors provide excellent computer hardware and software programs to assist local units meet their general ledger requirements.

The Local Finance Board has proposed formalizing Technical Accounting Directive #3 in the Board's rules at N.J.A.C. 5:30-5.7. This Local Finance Notice reinforces and updates the procedures for maintaining a General Ledger Accounting System.

Technical Directive - Restated

The general ledger is a local unit's official permanent record summarizing of all financial transactions recorded in the double-entry accounting system books of original entry. A general ledger accounting system supports the "fund" basis of accounting required by the Division of Local Government Services. Each fund must be able to provide for the immediate and current identification of its assets, liabilities, revenues, expenditures and fund balance. This is accomplished by using a self-balancing chart of accounts for each fund, using a general ledger accounting system. The general ledger, together with the books of original entry (described below), and supporting subsidiary ledgers, constitute a complete accounting system.

The implementation and utilization of a fully functional general ledger accounting system facilitates the preparation of the following financial documents that are required by the Division:

- Annual Debt Statement (ADS)
- Annual Financial Statement (AFS)
- Supplemental Debt Statement (SDS)
- Budget document

Required Books of Original Entry

In support of the general ledger, the following books of original entry (journals) are required to be maintained, either in a manual or an electronic format:

1. Cash Receipts Journal: Used to record all transactions where cash is received by the local unit; either for revenue or non-revenue (reimbursement of expenditures).
2. Cash Disbursements Journal: Used to record all transactions where cash is disbursed by the local unit for any purpose such as: budget appropriations, grant expenditures, capital ordinances, trust funds or payroll. While many of these transactions are the result of the satisfaction (payments) of a purchase order generated in an encumbrance journal, there must be a separate cash disbursements journal.
3. Payroll Journal: Used to record the details of each payroll for each employee indicating the pay period, employee's name, hours worked, rate of pay, overtime, and payroll deductions.
4. General Journal: Used to record any transactions that cannot be recorded in any other journals. Examples of journal entries in the general journal include:
 - Opening accounts at the beginning of the accounting period
 - Recording temporary and adopted budgets
 - Closing budgetary and operating accounts at the end of the accounting period
 - Recording adjusting entries or corrections to previously recorded transactions
 - Recording non-cash budgetary transactions such as:
 - Charging deferred charges to appropriations
 - Charging surplus to realized revenue
 - Charging state and federal grants
 - Charging reserve for uncollected taxes to appropriations
 - Recording non-municipal tax levies
 - The recording of the adoption of bond ordinances
 - The recording of grant awards

Use of the General Ledger

Postings are not made directly to the general ledger, unless first recorded in one of the books of original entry. The general ledger is the final record in which a financial transaction is recorded. A completed accounting transaction would involve the following steps:

- A documented and supportable transaction such as:
 - A receipt
 - A disbursement
 - The adopted budget
 - A voided check

- A governing body resolution
- An adopted bond ordinance
- The transaction is recorded in the applicable book of original entry.
- The transactions are then posted from the book of original entry to the general ledger accounts that are affected

Computerized account systems record all transactions into the book of original entry, posting them seamlessly to the general ledger. While it may appear from the vantage point of the user that the separate steps are not being taken, the software creates an audit trail from the transaction to the book of original entry to the general ledger.

At the beginning of the fiscal period,¹ before any current period transactions are recorded, the general ledger accounts will reflect opening balances in asset, liability, reserves and fund balance only. At the end of each accounting period (normally monthly) the books of original entry are closed by totaling the recorded transactions, and then posting those totals to the general ledger. For funds with little complexity or few transactions, the closing may be done only at the end of the fiscal year.

General ledger accounts should reflect the following normal balances at the end of each accounting period.

- Balance Sheet Accounts
 - Assets – debit balances
 - Liabilities – credit balances
 - Reserves – credit balances
 - Fund Balance – credit balances
- Budgetary and Operating Accounts
 - Anticipated Revenues – debit balances
 - Appropriations – credit balances
 - Revenues – credit balances
 - Expenditures – debit balances
 - Encumbrances – debit balances

Chart of Accounts

In 2000, the Division adopted the [Flexible Chart of Accounts \(FCOA\)](#) to improve the financial reporting among local units. Although the FCOA is not required to be implemented for general accounting systems, its use is strongly recommended (and is used by most NJ local unit accounting system providers). It provides an excellent base for a chart of accounts to meet the needs of the local unit. A standardized, well-structured chart of accounts is necessary for the following reasons:

- It provides for the recording of financial information in a consistent manner.
- It makes compilation of financial data for comparison with other local units possible.
- It serves as the basis for accounting, financial reporting (AFS, ADS), preparation, execution and management of the budget and the compilation of financial statistics on a local, state and national level.

¹ January 1 for calendar year local units and July 1 for state fiscal year local units.

Best Practices – Audit

Maintenance of an accurate and up to date general ledger is the cornerstone of sound financial and fiscal practices. It provides elected and appointed officials with the confidence that the budget, the adopted spending plan, is being followed. It also provides the basis for the chief financial officer to complete the required financial documents (ADS, AFS) as opposed to the registered municipal accountant doing that work.

While the RMA completes the AFS and ADS in many municipalities, and may construct the general ledger in others, these practices present a challenge to local units. The distinction of who performs the work, the CFO or the RMA has become more important in recent years due to the issue of “auditor independence,” as the auditor should not conduct an audit of work the auditor performed for their client.

This issue become more prominent in June 2003, when the Unites States General Accounting Office issued a revised edition of its Government Auditing Standards (“Yellow Book”). The Yellow Book is the official document that sets the standards for government auditing practices. The independence issue was a critical element of the revisions. Chapter 3 of the revised Yellow Book addresses the issue as follows:

Section 3.13:“...(1) Audit organizations should not provide non-audit services that involve performing management functions or making management decisions and (2) audit organizations should not audit their own work or provide non-audit services in situations where the non-audit services are significant/material to the subject matter of audits.”

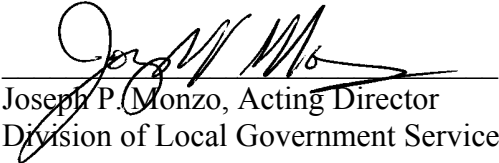
Section 3.14 “...Audit organizations should not perform management functions or make management decisions. Performing management functions or making management decisions creates a situation that impairs the audit organizations independence, both in fact and in appearance, to perform audits of that subject matter and may affect the audit organizations independence to conduct audits of related subject matter.” For example, auditors should not serve as members of an entity’s management committee or board of directors, make policy decisions that affect direction and operation of an entity’s programs, supervise entity employees, develop programmatic policy, authorize an entity’s transactions, or maintain custody of an entity’s assets...”

It is clear from these excerpts that the preparation and/or closing of the general ledger relative to the presentation of financial condition represents a potential conflict with auditor independence. These are areas of management decision and prerogative and local units leaders should carefully review their practices to ensure that auditor independence is not compromised. Ideally, the local unit staff, with responsibility vested in the Chief Financial Officer should be responsible for the implementation, maintenance and integrity of the local unit’s accounting system.

Conclusion

The maintenance of a general ledger for all funds is an essential element of the local unit financial accounting system. With today’s reliance on accurate and timely financial decisions, municipalities can no longer operate without a complete general ledger accounting system.

If you have any questions or need assistance on this notice please contact the Bureau of Finance Regulation at 609-292-4806 or by e-mailing dlgs@dca.state.nj.us.


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