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New Jersey Department of Community Affairs  
Division of Local Government Services

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Date

# LOCAL FINANCE NOTICE

CHRISTINE TODD WHITMAN  
GOVERNOR

JANE M. KENNY  
COMMISSIONER

ULRICH H. STEINBERG, JR.  
DIRECTOR

## DLGS REPORTS: Financial Management Improvement Program and the GAAP Pilot Program

It is with great pleasure that I am able to announce to the State's local government community the results of an effort begun over four years ago to study a number of issues surrounding the State's financial oversight and fiscal integrity of local government units.

The Financial Management Improvement Program was initially aimed at reviewing our municipal and county financial reporting systems and to prepare us to use contemporary information technology to move from a paper oriented system to an electronic one. The effort included a study of using Generally Accepted Accounting Principles (GAAP) promulgated by the Government Accounting Standards Board (GASB) as a reporting model for counties and municipalities. The project also developed a flexible chart of accounts for counties and municipalities, and conducted a feasibility study of developing a "Local Unit Budget Approval and Reporting System" (LUBARS).

The key conclusion of the report is that all local units supervised by the Local Finance Board and Division should operate under the same budget and financial reporting rules. To achieve that end, the report recommends that the State should adopt a single budget and GAAP reporting model for all municipalities, counties, authorities, and fire districts. Further, this should be done in a way that retains the crucial fiscal integrity and oversight elements that comprise the existing municipal/county system and then integrate authorities and fire districts to the system. Finally, the new system should be designed to integrate contemporary information technology into the system to take advantage of the data processing and public access capabilities it provides.

The report further recommends that an effort to develop this new model should begin as soon as possible. This would be followed by a period of review of the impact of the proposal by all affected government and public parties. Only then, should a final recommendation be made to the Local Finance Board, and subsequently to the Governor and Legislature. A presentation on the report was made to the Local Finance Board on September 13, 2000.

I hope you welcome this opportunity to review and re-engineer our systems. For municipalities and counties, it's a hard look at a system that has been effectively unchanged for over 40 years; for fire districts, even longer; and for authorities, an opportunity to meet public expectations of budgetary disclosures that are inherent to our system, but never met.

Director's Office  
(609) 292-6613

Local Government  
Research  
(609) 292-6110

Financial Regulation  
and Assistance  
(609) 292-4806

Local Finance  
Board  
(609) 292-0479

Local Management  
Services  
(609) 292-7842

Authority Regulation  
(609) 984-0132

Fax  
(609) 984-7388

101 South Broad Street

P.O. Box 803

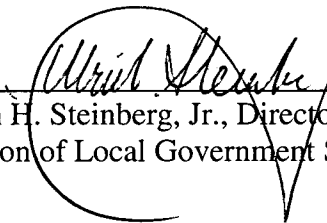
Trenton, New Jersey 08625-0803

<http://www.state.nj.us/dca/lgspages/dcadlgs.htm>

Over the next several weeks I will establish a panel of experts to review the recommendations and to take the first steps at re-engineering the system to meet the goals expressed in the report. Once that is completed, a larger task force representing all interests will be appointed to study the proposal. During this time, we will also start developing a formal request for proposals document for a vendor to develop LUBARS.

An Executive Summary of the 40 page report is enclosed with this Notice. The full report is available for viewing and downloading on the Division's web site ([www.state.nj.us/dca/lgspages/dcadlgs.htm](http://www.state.nj.us/dca/lgspages/dcadlgs.htm)). Printed copies are also available from the Division by calling (609) 341-3222.

**Recipients of this Notice are asked to distribute copies to their governing bodies, chief administrator, and finance officers of their local unit.**



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Ulrich H. Steinberg, Jr., Director  
Division of Local Government Services

Enclosure

Distribution:

Municipal Clerks, Clerks to Boards of Freeholders, Authority Executive Directors, Chairs of Fire Districts  
Registered Municipal Accountants, and Authority and Fire District Auditors  
Certified Municipal and County Finance Officers

With full report:

Governor Christine Todd Whitman  
Members of the State Legislature  
State Treasurer Roland M. Machold  
Attorney General John J. Farmer, Jr.  
Charlene Holzbaur, Director, Office of Management and Budget

# Financial Management Improvement Program Report – Executive Summary

## Division of Local Government Services

### Introduction

In 1995, the Division of Local Government Services was authorized to conduct a pilot program to test the then current version of Generally Accepted Accounting Principles (GAAP - as promulgated by GASB, the Government Accounting Standards Board) as a new model of financial reporting for municipalities and counties. In addition, the Division proposed a Financial Management Improvement Program (FMIP). Its purpose was to start initiatives to examine and update municipal and county government accounting and financial reporting practices. This would set the groundwork for development of an electronic model of budget oversight and approval that will provide improved productivity and public access to information. The program included the following major initiatives:

- GASB GAAP Financial Reporting Pilot Program – the test to see the impact of GAAP principles on the State’s existing oversight/solvency system.
- Local Unit Budget Approval and Reporting System (LUBARS) Feasibility – an automated budget and financial statement preparation and review process
- Development of a Flexible Chart of Accounts – necessary to accommodate electronic filing of financial documents
- Development of a NJ Comprehensive Annual Financial Report – converting the existing and outdated Annual Audit to a reporting model based on GAAP formats using the current oversight/solvency model.

### Report on Program Elements

The GAAP Pilot program included 19 municipalities and 2 counties. The participants included a mix of different sizes of organizations from Wrightstown to Jersey City, and Bergen and Warren counties. The program provided funds for the participants to prepare a GAAP Comprehensive Annual Financial Report (CAFR) in addition to the statutorily required OCBOA-based audit report. That effort has been completed, and the Division reports the following findings:

- Annual conversions from the State’s traditional Other Comprehensive Basis Of Accounting (OCBOA) to GAAP reporting can be done, though there are complications in dealing with elements unique to OCBOA. Among them are calculation of surplus, handling of reserve year budgets, and recognition of revenues.

- Using GAAP reporting (notwithstanding the cost and mandate question) in conjunction with the current budgeting and accounting system would create confusion with the public due to differences between budgeting model (OCBOA) and the formal financial report (CAFR).
- Cost of converting from OCBOA to GAAP can run from \$10,000 to \$30,000 per year, depending on the size of the municipality, and higher for larger, more complex organizations.
- The program concluded that the confusion created by dual-systems and the cost of paying for reporting under both models is unreasonable.

The report ends with the following observations:

“... GAAP rules can work for New Jersey municipal and county financial reporting (as it currently does for authority and fire districts) only if we recast our solvency and oversight models to incorporate GAAP principles. It will take some effort to develop the changes that are necessary and to educate not only practitioners but the public as well. But it should be seriously considered. Since GASB has finalized its long discussed changes to the reporting model, State officials will come under increasing pressure to justify why we are not using GAAP for our reporting. We believe it is a justification that will become increasingly more difficult to make.”

The LUBARS study effort resulted in a conclusion that there is significant value to the Division, the State, and the public in deploying LUBARS. That value is:

- Elimination of a decades old and now archaic paper-based system;
- A faster and more effective process for budget review and approval;
- Improved employee productivity at all levels;
- Reassignment of staff to accomplish higher value activities; and
- Real-time budget information that enables information to be used by policy makers and the public to enhance local accountability and improve policy making at all levels.

While the Program’s work continued over the years, changes were taking place in both technology and government accounting. Of specific importance is the advent of the Internet, dramatic changes in

technology, and GASB's release of Statement #34 – the long awaited update to the government financial reporting model. All play a critical role in the future of the State's interest in local government finances.

Finally, the Flexible Chart of Accounts has been issued, training undertaken, and it has been implemented with CY 2000 budgets. The NJ CAFR model has been completed, but not released as of this time, since the adoption of Statement #34 by the Government Accounting Standards Board revising GAAP reporting requires modifications to it.

### Conclusions of the FMIP

When viewing the FMIP effort as a whole, the Division has reached several findings about the future of New Jersey local government financial reporting and oversight. They are:

- The promulgation of GASB Statement 34 will ultimately make it harder for New Jersey to justify a non-GAAP reporting model for its local governments. There are fewer reasons to resist, if the oversight/solvency model (with necessary changes to the FCOA) can be restructured to allow for GAAP principles.
- Development of LUBARS under the OCBOA model leaves us open to the possibility that it would be interrupted by a later decision to convert to GAAP reporting, possibly wasting a good deal of time, effort, and money.
- The FCOA can be implemented under any scenario – it is sufficiently flexible to accommodate either an OCBOA or GAAP structure, and, with slight modification, could also handle authority and fire district needs.
- The NJ CAFR could be deployed to serve as an interim step to GAAP reporting, as the structure will be essentially similar to a GAAP CAFR, though this action is **not** recommended in light of the other proposed initiatives.
- If taken together, LUBARS and migration to the GAAP reporting model (that is matched to an oversight system) presents us new opportunities. Not only would it provide improved public disclosure of information and encourage increased citizen participation in government, it allows for the development of a **single standard** for budget review and oversight of **all** local units; municipal, county, authority, and fire district.

The conclusion that if GAAP were incorporated into our system by restructuring our oversight/solvency systems to accommodate it, we can eliminate the three different oversight and reporting systems we

maintain. Having a single system also eliminates the ultimate necessity to build separate LUBARS for all units and would provide common budgeting, accounting, reporting, and oversight practices. There are many advantages to having a common platform for data; ease of handling data and consistency among them.

Thus, the next step would be to put LUBARS on hold for the moment and move forward to redesign the oversight/solvency model to integrate all local units, contemporary information needs, technology, and GAAP principles into a single LUBARS system.

### Next Steps

The model we have described needs to be evaluated by leaders and experts in the government finance field to test its assumptions and see if continued work has merit. We must see if any critical issues have been overlooked. Subject to modifications from that step, it must then be exposed to government finance practitioners and students of public policy, and receive the benefit of their comments so that principles for implementation can be established.

Once principles are in place, work can begin on the first step toward implementation: rewriting the Local Budget Law, fire district law, and other related statutes and regulations. Concurrently, LUBARS development can commence, to be aligned with the statutory revisions, development of training and educational material, and finally, testing (and changes from it), training and implementation. The effort is a significant management challenge and will need the allocation of necessary resources and the attention of concerned parties.

The FMIP process started the first comprehensive review of the State's process for assuring municipal and county financial solvency in almost 40 years. Since it was established, the State's once leading edge system fell victim to time and change. It is now time to take advantage of the confluence of technology and new standards to leap ahead with new techniques, keeping in mind the tradition and successes of the past.

The full report can be found on the Division's web site at [www.nj.state.nj.us/dca/lgs](http://www.nj.state.nj.us/dca/lgs) [REDACTED]. A printed copy can be obtained by calling the Division at 609-292-6604.