

## SUBCHAPTER 7. ACCOUNTING AND AUDITING

### 5:31-7.1 Accounting and financial reporting systems

- (a) The accounting system consists of the methods and records established to identify, assemble, analyze, classify, record, and report an entity's transactions and to maintain accountability for the related assets and liabilities.
- (b) An effective accounting system shall include a double-entry accounting for all transactions resulting in a general ledger, which shall be required for all authorities and special districts.
- (c) Any accounting system adopted pursuant to (a) and (b) above must make it possible to present fairly and with full disclosure the financial position and results of financial operations of the funds and account groups of the reporting entity, in conformity with generally accepted accounting principles (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB), 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, incorporated herein by reference, as may be amended from time to time, and demonstrate compliance with finance-related legal and contractual provisions, including applicable security and financing agreements.
- (d) GAAP as it applies to proprietary funds of state and local governments, specifically as it applies to enterprise funds shall be used to account for an authority's ongoing activities, similar to those found in the private sector, where the intent of the governing body is that the costs (expenses, including depreciation) of providing services to the general public on a continuing basis be financed or recovered primarily through user charges and/or where the governing body has decided that periodic determination of revenue earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.
- (e) The financial statements of authorities shall be prepared in accordance with GAAP applicable to enterprise funds. Accordingly, revenues and expenses shall be recognized on the accrual basis. Revenues shall be recognized in the accounting period in which they are earned and become measurable; expenses shall be recognized in the period incurred, if measurable.
- (f) The financial statements of special districts shall be prepared in accordance with GAAP applicable to governmental funds of state and local governments. Accordingly, revenues and expenditures shall be recognized on the modified accrual basis. Revenues shall be recognized in the accounting period in which they become available and measurable. Expenditures shall be recognized in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on general long-term debt, which shall be recognized when due.

**5:31-7.2 Establishment of an internal control structure**

- (a) The governing body of each authority and special district is responsible for establishing and maintaining an internal control structure. An entity's internal control structure shall consist of policies and procedures established to provide reasonable assurance that specific entity objectives and proper conduct of the entity's business with full accountability for the resources made available, shall be achieved. In fulfilling this responsibility, estimates and judgments by the governing body are required to assess the expected benefits and related costs of internal control structure policies and procedures.
- (b) The objectives of an internal control structure should provide the governing body with reasonable, but not necessarily absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with the respective governing body's authorization and recorded properly to permit the preparation of financial statements in accordance with GAAP.

**5:31-7.3 Determining the financial reporting entity**

The definition of a financial reporting entity shall be based on the concept of financial accountability. A primary objective of authorities' and special districts' financial reporting should be to provide users of financial statements with a basis for assessing the accountability of their respective elected/appointed officials, responsible for the operations of their specially created organizations. The financial statements of the reporting entity shall provide for distinguishing between the following: primary government, component unit, joint venture, jointly governed organization, or another stand-alone government, by communicating such information to the users thereof. Such selection of the financial reporting entity shall be made by the governing body pursuant to GAAP criteria and be presented in the entity's financial statements pursuant to GAAP reporting standards.

**5:31-7.4 Interim financial reporting**

For both authorities and special districts, interim financial reports should be comprised principally of statements that reflect current financial position at the end of a month or quarter and compare actual financial results with budgetary estimates and limitations. Appropriate interim financial statements and reports of financial position, operating results, and other pertinent information should be prepared primarily for purposes of governing body control of financial operations, facilitate regulatory budgetary oversight, and where necessary for external reporting purposes. All such interim reports need not be prepared on a GAAP basis, unless internally required, but all such reports may be subject to audit pursuant to N.J.S.A. 40A:5A-15.

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### **5:31-7.5 Compliance with legal provisions**

Generally both authorities and special districts are required to follow the applicable provisions of statute and at times such legal provisions may conflict with GAAP. Conflicts between legal provisions and GAAP do not require maintaining two accounting systems. Instead, the accounting system can be maintained on a legal compliance basis, but should include sufficient additional information to permit GAAP based reporting. Specifically, authorities and special districts both have a prescribed budgetary basis to demonstrate legal compliance; notwithstanding, sufficient supplemental records shall be kept to permit presentation of financial statements in conformity with GAAP.

### **5:31-7.6 Auditing procedures and scope**

- (a) Each authority and special district shall conduct an annual audit for their respective fiscal year in accordance with: generally accepted auditing standards (GAAS), as promulgated by the American Institute of Certified Public Accountants (AICPA), Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881, incorporated herein by reference, as may be amended from time to time; Government Auditing Standards (often called the Yellow Book, General Accepted Government Auditing Standards, or GAGAS) issued by the Comptroller General of the United States and the United States General Accounting Office (GAO) at the United States General Accounting Office, Washington, D.C. 20548, and those audit standards having been adopted as rules by the Local Finance Board and the Division of Local Government Services, Department of Community Affairs, State of New Jersey. Those standards require that an independent auditor plan and perform an audit to obtain reasonable assurance that the financial statements of the reporting entity are free of material misstatement. These basic financial statements shall include, but not be limited to: a balance sheet and the related statements of revenues, expenses/expenditures and changes in retained earnings/fund balance and cash flows for the year then ended. Notwithstanding that such statements presented are the responsibility of the respective governing bodies involved, the independent auditor engaged to perform the audit, shall express an opinion on the financial statements taken as a whole.
- (b) Any audit performed pursuant to (a) above must include examining on a test basis and evidence supporting the amounts and disclosures in the financial statements. Any such audit must include an assessment of the accounting principles used and significant estimates made by the governing body or its administration, and must further include such additional procedures as shall be required by any security/financing agreement, as well as an evaluation of the overall financial statement presentation. Any supplementary information presented shall be subjected to the auditing procedures applied in the audit of the financial statements and an opinion rendered in relation to the financial statements taken as a whole.

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- (c) Accompanying the Independent Auditor's Report on Financial Statements and on Supplementary Information and Schedules, shall be a Report on the Internal Control Structure and a Compliance Report. Where applicable with respect to Single Audit filings, a Report on Supplementary Information Schedules of Federal and State Financial Assistance must be prepared, including any other general or specific reports as may be required by Government Auditing Standards and Federal and/or State requirements and circulars.
- (d) All authority and special district audits shall be completed and the audit reports thereon shall be filed with the governing bodies within four months after the close of the authority's fiscal year or within such shorter period specified in the authority's security or financing agreement, or in the statute authorizing the creation of the authority or special district. After expiration of the due date, the Division shall have the prerogative to perform the audit itself or to engage an independent auditor to conduct such audit. The costs of any such work, after approval by the Director, shall be billed to and paid for by the respective authority/special district.
- (e) Within five days after the audit report is filed with the authority/ special district, the auditor shall file a copy with the Director and with the governing body of each local unit having created same.
- (f) The auditor shall complete the prescribed Division audit questionnaires as prescribed in Appendix A and Appendix B, incorporated herein by reference, to be made part of the working-papers. However, the questionnaire will be subject to review by the Director. The respective questionnaire is not to be filed with the authority or special district being audited.
- (g) The synopsis of an authority/special district annual audit is required to be published by statute and shall forthwith be filed with the Division, within 10 days after publication, and shall include the following:
  - 1. A comparative balance sheet;
  - 2. A comparative statement of revenue, expenses/expenditures and changes in retained earnings/fund balance;
  - 3. A summary of recommendations; and
  - 4. Single Audit findings.
- (h) The governing body of each authority/special district, within 45 days of receipt of the annual audit shall certify by resolution that each member thereof has personally reviewed the annual audit report. Specifically, the sections of the audit report entitled Comments and Recommendations and Schedule of Findings and Questioned Costs shall be evidenced by group affidavit in the form prescribed by the Local Finance Board in Appendix C, incorporated herein by reference, and shall be filed forthwith to the Division.

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- (i) A corrective action plan, in the form of a resolution, to be adopted by the members of the governing body with respect to comments and recommendations made in the audit, shall be filed forthwith with the Division within 45 days of receipt of the annual audit.

### **5:31-7.7 Discovery of fraud or illegal acts**

- (a) The Division of Local Government Services has the prerogative to take full charge of the auditing of any authority or special district where there is any shortage, embezzlement or fraud. Where there is detection of an illegal act, shortage or irregularity, the Division shall be notified at once by means of a special confidential report. Notwithstanding, guidance on the independent auditor's responsibility for the detection of illegal acts and irregularities in an audit of financial statements is provided by generally accepted auditing standards.
- (b) Confidential report blanks shall be submitted in triplicate; one copy for filing in this Division, one copy for filing with the authority/ special district and the third copy for the auditor's files. Blanks can be procured upon request and may be secured either in advance or immediately upon the discovery of any condition requiring a special report. The special confidential report (see Appendix D, incorporated herein by reference) shall be prepared as follows:
  - 1. Section One is a preliminary report and must be filed with the Division within forty-eight hours after the discovery of any irregularity or shortage regardless of whether or not the facts have been definitely established;
  - 2. Section Two shall be filed immediately after the auditor has completed the work or after the auditor has completed the preliminary work to a point where the auditor can make a fair determination as to the amount involved. The auditor shall file supplements or preliminary reports from time to time pending the filing of section two in completed form.
  - 3. Section Three shall be filed upon final disposition of the case.
- (c) In connection with every shortage there shall be an immediate report to the Division of Local Government Services, Bureau of Authority Regulation, and the governing body. The governing body shall make immediate report to the bonding company upon presentation of the preliminary report of the auditor. It is the duty of the governing body to report the discovery of any shortage or irregularity involving public moneys to the County prosecutor serving the County in which the entity is located. The Director is not a prosecuting officer, but shall render a report to the responsible Deputy Attorney General. The independent auditor shall follow up these matters in each and every instance and keep the Division informed as to progress and procedure.

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### **5:31-7.8 Audit reports and financial reporting practices for authorities and special districts**

- (a) The pronouncements of the Governmental Accounting Standards Board (GASB) and Financial Accounting Standards Board (FASB) shall control with respect to the application of GAAP for authorities and special districts, except that Local Finance Board rules as set forth in the New Jersey Administrative Code, including financial oversight and Division regulatory responsibilities, including review and approval of annual budgets pursuant to statute, shall apply and supersede where applicable.
- (b) Financial reporting under GAAP requires general purpose financial statements (GPFS) and/or component unit financial statements (CUFS), as minimum acceptable presentation for governmental financial reporting purposes. The primary reporting entity focus of separately issued GPFS/CUFS should be on financial information aggregated by fund type, account group, and discretely presented component units. Such aggregated financial information presented shall constitute fair presentation in conformity with GAAP. If the governmental organization other than a primary government serves as a nucleus for its own reporting entity when it issues separate financial statements, then the reporting entity's financial statements should present the fund types and account groups as if it were a primary government (including its blended component units, which are, in substance, part of the primary government) and provide an overview of the discretely presented component units.
- (c) The following statements shall be included in the GPFS/CUFS, as applicable, for authorities/special districts as necessary for separately issued financial statements to be presented fairly in conformity with GAAP:
  - 1. Combined Balance Sheet--All Fund Types, Account Groups, and Discretely Presented Component Units;
  - 2. Combined Statement of Revenues, Expenditures, and Changes in Fund Balances--All Governmental Fund Types and Discretely Presented Component Units;
  - 3. Combined Statement of Revenues, Expenditures, and Changes in Fund Balances--Budget and Actual--General and Special Revenue Fund Types (and similar governmental fund types of the primary government for which annual budgets have been legally adopted);
  - 4. Combined Statement of Revenues, Expenses, and Changes in Retained Earnings (or Equity)--All Proprietary Fund Types and Discretely Presented Component Units;
  - 5. Combined Statement of Cash Flows--All Proprietary Fund Types and Discretely Presented Component Units;
  - 6. Notes to the financial statements; and
  - 7. Required supplementary information.

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- (d) Additional or alternative financial reporting presentations or formats, other than those stated in (c) above, may be necessary pursuant to State or Federal requirements or supplementary information on a specific GPFS/CUFS, as requested by the Director of the Division of Local Government Services and/or the Local Finance Board.

### **5:31-7.9 Audit of Federal and State grants**

- (a) The auditor's reporting responsibility in audits of Federal and State financial assistance is primarily driven by four levels of auditing standards and requirements that shall apply:
  - 1. Generally accepted auditing standards issued by the American Institute of Certified Public Accounts;
  - 2. Government Auditing Standards issued by the United States General Accounting Office;
  - 3. Single Audit Act and applicable Federal OMB Circulars;
  - 4. Single Audit policy for recipients of federal grants, state grants and state aid and applicable State of New Jersey OMB Circulars.
- (b) The guidance in (a) above represents a level of auditor responsibility for reporting on an entity's financial statements, internal control structure and compliance with applicable laws and regulations, when followed.