ACCOUNTING RECORDS AND SOURCE DOCUMENTATION

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Introduction

As noted in the previous chapter, an essential element of an effective financial management system is maintaining adequate accounting records and source documents. Accounting documents and records are the physical objects upon which transactions are entered and summarized. Examples include such items as cancelled checks, paid bills, payrolls, subsidiary ledgers, bank reconciliations, etc.

This chapter discusses a number of general and specific principles governing accounting records and source documents that recipients of state DHSS funds must meet. A few of the broad, essential requirements are:

- accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subcontract award documents, etc;
- grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially assisted activities;
- accounting records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income; and
- documents must be adequate to provide reasonable assurance that all assets are properly controlled and that all transactions and events are properly identified and recorded.

Grantees must meet these and other standards for adequate accounting records for several reasons. Both the accounting documents of original entry and the records upon which transactions are entered are essential elements of the internal control structure. Without adequate records, the entity cannot effectively control fiscal operations through standard budgetary and fiscal reporting processes. Not maintaining adequate records also increases an entity's risk of being subject to fraud.
In addition, maintaining adequate accounting records is required to meet basic, widely accepted standards of accountability. The entity's independent auditor will examine and test accounting records and source documentation as a part of the audit in order to substantiate the information that appears in the financial statements. In an audit involving financial assistance, expenditures and other transactions that are not supported by adequate documentation may result in questioned and/or disallowed costs, which the grantee may have to pay back to the grantor agency.

To provide grantees with a greater understanding of the standards for accounting records and source documentation required by the Department, this chapter discusses in further detail:

- criteria for accounting documents and records;
- the accounting procedures manual;
- the chart of accounts; and
- nine essential principles for accounting records which the Department believes are necessary for properly recording and reporting financial transactions related to financial assistance programs.

**Criteria for Accounting Documents and Records**

To ensure that an entity's accounting system effectively meets the entity's accounting, fiscal control, and financial reporting needs, the entity's accounting records and source documents should be:

- pre-numbered consecutively and accounted for by someone other than the preparer to facilitate control over missing documents and to aid in locating documents when they are needed at a later date;
- prepared at the time of the transaction or as soon afterward as possible in order to reduce the likelihood of error;
- sufficiently simple so that they can be readily understood;
- designed for multiple use whenever possible, which can help minimize the number of different forms and reduce the duplication of effort;
- constructed in a manner that encourages correct preparation and transfer of information through internal checks within the form or record, for example including instructions for proper routing, spaces for authorizations and approvals, footing and cross-footing, and pre-printed data; and
- designed to illustrate/document compliance with requirements applicable to financial assistance programs.

**Accounting Procedures Manual**

The procedures for proper recordkeeping should be spelled out in an accounting procedures manual to assist personnel in understanding and applying appropriate procedures. The manual should describe the flow of documents throughout the organization, the responsibilities of each person involved in the process, and instructions for appropriately preparing documents and records. The manual should be
Accounting records and source documentation are periodically updated to reflect changing conditions.

If an agency needs assistance in either creating or updating its written accounting procedures, independent audit firms and other financial management consultants can be a source of assistance. The agency can also seek out peer agencies to obtain examples and gain insight into how others have met this key financial management responsibility.

Chart of Accounts

The chart of accounts, which classifies transactions into individual balance sheet and income statement accounts is closely related to documents and records. The chart of accounts provides the framework for gathering the information necessary for management to make effective decisions and for the preparation of the financial statements in accordance with generally accepted accounting principles.

A properly designed chart of accounts can also facilitate the preparation of financial reports sent to grantor agencies for claiming reimbursement of expenses, reporting program results, etc. A chart of accounts which accurately and comprehensively describes the types of transactions which should be in particular accounts can help prevent misclassification of transactions.

The chart of accounts for a particular organization is affected by organizational structure, budgeting practices, the accounting system, and types of reports to be generated. The chart of accounts should have the following account groups:

- assets;
- liabilities;
- equity or fund balance;
- revenues; and
- expenditures.

The level of detail in the chart of accounts will depend on the characteristics of the agency and the type of financial assistance programs administered by the agency. Generally, the chart of accounts should classify revenues by fund and source and classify expenditures by fund, function (or program), organizational unit, activity (specific type of expenditure), character (operating, capital, transfer), and object class (type of item or service).

Nine Principles Governing Accounting Records

DHSS has identified nine principles for accounting records drawn largely from generally accepted accounting principles that it believes are necessary for properly recording and reporting financial transactions related to financial assistance programs. An agency's accounting system should include provision for the following principles:
1. **Double-Entry Bookkeeping.**

A double-entry accounting system establishes essential controls to protect, in part, against unauthorized or inappropriate transactions and to provide a sound basis for financial reporting in accordance with generally accepted accounting principles. A double-entry accounting system:

- maintains a balance between assets on one hand and liabilities and fund balance on the other to produce a balance sheet;
- maintains a balance between revenues and other resources on one hand and expenditures and fund balance on the other to produce a statement of revenues and expenditures; and
- requires maintaining this balance by making a debit entry, to an account(s) for every credit entry made to a corresponding account(s).

If necessary, and depending on an agency's size, an independent auditor or accountant can be a source of assistance setting up a bookkeeping system that is tailored to an organization's needs.

2. **Fund Accounting.**

A fund is a separate self-balancing set of accounts recording financial resources and the related liabilities and equity that are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

For *governments*, governmental generally-accepted accounting principles require fund accounting. The funds used are:

- Governmental Funds (General Fund, Special Revenue Funds, Capital Projects Funds, and Debt Service Funds);
- Proprietary Funds (Enterprise Funds, Internal Service Funds); and
- Fiduciary Funds (Trust and Agency Funds).

The fund category -- governmental, proprietary, or fiduciary -- determines the basis of accounting.
Governmental funds use modified accrual accounting, while proprietary funds use accrual accounting. Fiduciary funds use the basis consistent with the accounting measurement objective.

On the other hand, not-for-profit organizations typically use restricted and unrestricted funds to account for activities that require segregation and/or separate reporting. Fund type does not determine basis of accounting for not-for-profits.

3. Accounting on an Accrual or Modified Accrual Basis.
Not-for-profit organizations and governmental organizations operate under somewhat different bases of accounting. Generally, not-for-profit organizations are required to use accrual accounting while governmental organizations are required to use modified accrual accounting for governmental funds and accrual accounting for proprietary funds.

The accrual basis of accounting recognizes revenues in the accounting period in which they are earned and become measurable. Expenses should be recognized in the period incurred, if measurable.

The modified accrual basis of accounting recognizes revenues in the period when they become both measurable and available to finance expenditures of the current period. Under the modified accrual basis of accounting, expenditures should be recognized when measurable and generally when the liability is incurred and will be liquidated with current resources. For the liability to be incurred, the goods must be received in satisfactory condition and or the service must be performed.

The Department of Health and Social Services allows, at the option of the agency, a departure from accrual basis accounting for client fee receivables (i.e., private insurance companies, Title XVIII, Title XIX and other responsible parties). The reason for this departure is that in many cases it is not possible to reasonably estimate client fees that will actually be received.

4. Distinguishing Between Revenue and Expenditure Accounts.
Many kinds of economic events may lead to a reduced cost of goods and services used in operating programs. Three of these are listed below along with the different accounting treatment that each should receive.

A. Expenditure transactions which include taking a purchase discount or a quantity discount should be booked and reported net of these kinds of applicable credits.
B. When a vendor returns an amount that was overpaid, or offers an after-the-fact rebate or refund which is conditional upon first sending in a payment, such amounts should be treated as refunds of expenditures, which reduce previously recorded expenditures. Refunds of expenditures pertaining to current-year transactions should be credited to expenditure accounts. Refunds of expenditures to be received in a subsequent year should be accrued as a receivable. Separate accounts should be used for significant refunds related to a prior year.
C. Typically, any fees paid by program clients are revenues and should be credited to current-year revenue accounts.
5. **Treatment of Unearned Revenue.**
Under generally-accepted accounting principles, advances for grants are considered deferred revenue (unearned income) until expenditures are accrued. Revenue (earned income) is accrued as expenditures are made and reported to the funding agency.

Advances received from funding sources in excess of net reimbursable expenditures should be set up as a liability payable to the funding source (deferred revenue or accounts payable) and should not lapse to the general fund or be expended in a future accounting or contract period unless specifically authorized by the grantor in writing.

6. **Maintaining Control Over Receivables.**
Accounts receivable should be accrued and recorded on the books to maintain control and to report asset balances. Adequate subsidiary records should be maintained for documentation and for collection efforts.

A subsidiary journal should be maintained for accounts receivable which records invoices and collections for billable services provided. Control totals should be maintained, and an aging schedule of uncollected amounts should be periodically prepared. Write-off's should be approved by a person independent of the accounting records.

7. **Maintaining Inventory Records.**
Inventory purchases and issuances should be posted to inventory accounts. Perpetual inventory records should be maintained, and an annual physical inventory should be taken. Discrepancies between recorded inventory and counted inventory should be investigated, and inventory records should be adjusted as necessary.

The cost of inventory used in the current fiscal year should be recorded as an operating expense.

8. **Fixed Assets and Depreciation.**
To be considered a fixed asset, property must have three attributes:

- tangible nature;
- life longer than current fiscal year; and
- significant value (over $500).

Fixed assets are generally classified as land, land improvements, buildings, machinery and equipment, and construction in progress.

Maintaining accurate and complete records of fixed assets is required by generally accepted accounting principles, by federal and state regulations, and by good business practice. Records for fixed assets are needed in order to:
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- assist in identifying any loss or theft of property;
- determine amount of insurance coverage;
- assign responsibility for custody and maintenance;
- establish budgeting guidelines; and
- establish a basis for computing depreciation.

Property records should be maintained that include a description of the property the following information:

- a serial number or other identification number;
- the source of property;
- who holds title;
- the acquisition date;
- the acquisition cost;
- the percentage of federal and/or state participation in the cost of the property;
- the location of the property;
- the use and condition of the property;
- any ultimate disposition data including the date of disposal and sale price of the property; and
- if the depreciation method is used to claim reimbursement from a granting agency for use of the property, adequate depreciation records indicating the amount of depreciation taken each period must also be maintained.

A control system should be developed to ensure adequate safeguards to prevent loss, damage, or theft of property. A physical inventory of the property should be taken at least once every two years. The results of the inventory should be reconciled with the property records and any discrepancies should be investigated. In addition, maintenance procedures should be developed to keep the property in good condition.

Fixed assets should be recorded at cost. Donated assets should be recorded at fair market value at the time of donation. Estimates may be made for equipment purchased so long ago that records are not available.

Improvements which result in an increase in future service potential should be capitalized. Expenditures that keep the item in ordinary efficient operating condition should be classified as maintenance or repair expense.

Depreciation may be charged as a reimbursable expense. Under generally accepted accounting principles, depreciation is an allocation of the cost of an asset over the estimated useful value of the asset in a systematic and rational manner. Depreciation for the year is the portion of the total charge that is allocated to a particular year. Depreciation may be charged to grant programs providing that it meets the conditions of allowable cost requirements for depreciation and is allowable under the grant award. Under no circumstances should depreciation be charged to a grant for equipment that had been expensed.
Depreciation expense must be:

- identifiable and recorded in the agency's accounting records;
- based on the historical cost of the asset or fair market value at the time of donation; and
- prorated over the estimated useful life of the asset using straight-line method.

9. Record Retention.
All financial and programmatic records should be maintained for the period specified by the contract. If the contract does not specify a retention period, all records should be maintained for the periods specified in the applicable federal and/or state retention schedules. Federal retention schedules may be found in the Uniform Administrative Requirements Cost Principles, and Audit Requirements for Federal Awards - Uniform Administrative Requirements, and the sections of the Code of Federal Regulations applicable to the individual programs.

In order to meet some programmatic requirements, some types of records may need to be retained for periods longer than those cited in the documents listed above. Before deciding to destroy any record, one must consider carefully whether any such requirements exist.

For counties, the statutes address the destruction and retention of records. The primary governing statute is s. 19.21 "Custody and delivery of official property and records." This section should be consulted for a detailed discussion of record retention responsibilities imposed on counties by statute.

Some of the major record retention responsibilities imposed by statute are outlined below:

a. Generally, record retention periods for county records is to be determined by ordinance. No records can be disposed of unless a records ordinance has been approved by the Public Records and Forms Board. Staff in the Department of Administration (DOA) Records Management Section are available to provide assistance to county staff in developing appropriate ordinance language (phone number is (608) 266-2996).

b. The Wisconsin DHSS's Division of Community Services Memo Series memo DCS 92-12, issued in May, 1992, contains a discussion of record retention requirements for various types of records and includes an example of an approved ordinance. A copy of DCS 92-12 can be obtained by calling the Division of Economic Support's Mail Room at (608) 266-8896.

c. The retention periods for some records are specified by statute. It is good practice to also include these records in the ordinance.

d. For those records for which the retention period is not otherwise specified by statute, the retention period may not be less than 7 years unless a shorter period is set by the public records and forms board under s. 16.61 (3) (e).
The conclusion to be drawn from the last requirement above is that if a county is interested in minimizing the amount of time that it stores various types of records, it needs to draft a request for a shorter retention period, including the basis for requesting that shorter period, and submit it to the public forms and records board for review and approval.

Income maintenance programs require special records retention periods. Records documenting that clients received notices of overpayments must be retained until the overpayment issue is resolved, however long that takes. Currently, overpayments are considered closed when (a) the amount overpaid has been repaid leaving an overpayment balance of $0 (b) the overpayment has been cleared by a declaration of bankruptcy (c) the overpayment amount has been waived by a court or (d) the client is deceased leaving no estate. There is no statute of limitations on the federal portion of overpayments, while there is a state statute of limitations of 6 years for the state portion of debts, with the exception of cases of fraud for which there is no limitation. Contact the Division of Economic Support/Bureau of Management and Operations at (608) 267-2187 for additional information on records retention for income maintenance program overpayments.