

SECTION A BASIC PRINCIPLES

Accounting Principles

The financial records and statements of all Mississippi public school districts will be kept and presented in accordance with generally accepted accounting principles (GAAP) in the United States of America. GAAP for school districts are derived from the official pronouncements of the Governmental Accounting Standards Board (GASB). GASB is the accepted standard-setting body for governmental accounting and financial reporting principles. As GASB makes authoritative pronouncements, this manual will be updated.

On June 30, 1999, the Governmental Accounting Standards Board approved GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments. This Statement describes the minimum set of financial statements, note disclosures, and required supplementary information that must be presented in a financial report for an independent auditor to assert, without qualification or further comment, that a government's financial statements are fairly presented in conformity with GAAP. Implementation of GASB 34 reporting requirements will be detailed in Section N of this manual. Due to reporting requirements of the Mississippi Department of Education, the Basis of Accounting as noted below and all related sections of the manual, except Section N, must be implemented to meet reporting requirements of the Mississippi Department of Education.

Basis of Accounting

An entity's basis of accounting determines when transactions and economic events are reflected in its financial records. All Mississippi public school districts will prepare financial records using the modified accrual or accrual basis of accounting. The modified accrual or accrual basis of accounting, as appropriate, should be utilized in measuring financial position or operating results, as follows:

- A. Governmental fund revenues, expenditures, other financing sources and uses and related assets and liabilities should be recognized on the current financial resources measurement focus and the **modified accrual basis** accounting. Revenues should be recognized in the accounting period in which they become measurable and available. Measurable means knowing or being able to reasonably estimate the amount. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the district considers revenues to be available if they are collected within 60 days after year end. Expenditures should be recognized in the accounting period in which the fund liability is incurred, if measurable, except for debt service expenditures, which should be recognized when payment is due. Transfers should be recognized in the accounting period in which the inter-fund receivable and payable arise.
- B. Proprietary fund revenues, expenses and related assets and liabilities should be recognized on the **accrual basis**. There are two types of proprietary funds – internal service fund and enterprise fund. There are very few school districts that have proprietary funds. Revenues should be recognized in the accounting period in which they are earned and become measurable. Expenses should be recognized in the period incurred, if measurable.
- C. Fiduciary fund revenues and expenditures and related assets and liabilities should be recognized in the accounting period in which they become available and measurable. Expenditures should be recognized in the accounting period in which the fund liability is incurred, if measurable. Transfers should be recognized in the accounting period in which the inter-fund receivable and payable arise. Agency Fund assets and liabilities should be accounted for on the modified accrual basis.

The Modified Accrual Basis and Accrual Basis of accounting are described below.

Modified Accrual Basis:

Revenues:

Revenues are defined as an increase in the governmental unit's current financial resources. Revenues are recognized when they are susceptible to accrual, which means they must be both measurable and available to finance expenditures of the fiscal period. "Available" refers to the collectability of the receivable within the current period or soon enough thereafter to be used to pay for liabilities of the current period. A general criterion for availability is 60 days, although a longer or shorter period may be used, except for property taxes (where the maximum period may not be more than 60 days). The availability period will be disclosed in the notes to the financial statements. Each entity should adopt a revenue accrual policy that implements the susceptibility-to-accrual criterion and applies it consistently. This policy should also be disclosed in the notes to the financial statements. Revenues are measurable when the amount of the revenue is subject to reasonable estimation.

Expenditures:

Expenditures are recognized when the related liability is incurred, if measurable, except for interest and principal on general long-term debt, which is recognized when due and payable. Expenditures should be accrued at the end of the year when they are expected to use expendable financial resources. Generally, this means that expenditures that will be paid within a short period after the year-end are subject to year-end accrual.

Accrual Basis:

Revenues are recognized when the earning process is complete or virtually complete and an exchange has taken place. Accrual accounting attempts to record the financial effects of transactions and other events and circumstances that have cash consequences in the periods in which those transactions, events, and circumstances occur rather than only in the periods in which cash is received or paid. Accrual accounting is concerned with the process by which cash expended on resources and activities is returned as more (or perhaps less) cash, not just with the beginning and end of the process.

The essential elements of the accrual accounting method include:

1. The deferred outflows of resources and the subsequent amortization of the deferred costs (prepaid expenses, deferred charges, etc.),
2. The deferred inflows of resources until they are earned (property taxes received in advance).
3. The capitalization of certain expenditures and the subsequent depreciation of the capitalized costs (depreciation of cost of machinery), and
4. The accrual of revenues that have been earned and expenses that have been incurred.

Recognizing revenue under both methods of accounting normally results in recording certain receivables (assets). These receivables consist of the uncollected but realized portions of the related revenue recognized for the current period.

A liability account (deferred inflows of resources) results for certain cash and asset transactions when they are measurable but not yet earned. Cash received in advance and assets such as donated commodities

received and valued under the consumption method of inventory valuation are reported as deferred revenue (liability account) in these cases. The revenue is recognized when these type transactions have met both the measurable and earned criterion.

Fund Accounting

Governmental accounting systems should be organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

The following types of funds and account groups shall be used by Mississippi public school districts:

Governmental Funds

General Fund - to account for all financial resources except those required to be accounted for in another fund.

Special Revenue Funds - to account for the proceeds of specific revenue sources (other than sources for major capital projects or debt service) that are legally restricted or committed to expenditures for specified purposes.

Capital Projects Funds - to account for financial resources that are restricted, committed or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets.

Debt Service Funds - to account for the accumulation of financial resources that are restricted, committed, or assigned to expenditures for principal and interest (general long-term debt).

Permanent Funds - to account for assets held by the governmental unit where only the earnings (and not the principal) the assets generate may be used by the governmental unit.

Proprietary Funds

Enterprise Funds - to account for operations (a) that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Internal Service Funds - to account for the financing of goods or services provided by one department to other departments of the governmental unit, or to other governmental units, on a cost-reimbursement basis.

Fiduciary Funds

Custodial Funds - to account for resources held by a governmental unit on a temporary, purely custodial basis.

Private Purpose Trust Funds - to account for resources held by the governmental unit for others, in which the principal and income benefit individuals, private organizations or other governmental units (and that cannot be used to support the district's operations).

Account Groups

Since the issuance of GASB Statement 34 and the resulting financial reporting requirements, the General Fixed Asset Account Group and the General Long-term Debt Account Group are no longer necessary for proper financial statement presentation. However, some of the software providers may still utilize various components of the old "account group" coding structure to facilitate the preparation of the district-wide financial statements. Therefore, the references throughout the manual to these account groups have not been removed but are intended only to provide general guidance on necessary accounting entries relating to capital asset and long-term debt accounting with the understanding that these account groups are no longer required for presentation.

Internal Control Structure

An integral part of proper accounting procedures rests in issues of controls and begins with internal accountability structures. AICPA's Statement on Auditing Standards No. 78, Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55 (AICPA 1995)—which incorporates the Committee of Sponsoring Organizations' report, Internal Control Framework—indicates that the elaborateness of the system of internal controls established within a district is a matter of judgment on the part of management, with careful consideration for circumstances, such as the size of the district and the number of personnel and the relationship between the costs and benefits of designing and implementing controls. In addition, the nature of internal control is such that even appropriate methods and systems do not guarantee that a district's objectives will be achieved.

An internal control system is a system of ongoing processes that are built into the overall operations of your district. Having a strong internal control system provides reasonable (not absolute) assurance that your district objectives, which include your grant objectives, will be met.

A system of internal controls requires the participation of all levels of a district. Your daily business processes and organizational structure should reflect the internal control system you have in place for all funds. An effective system of internal controls allows you to ascertain that your records are accurate, your operations are efficient, and your policies and procedures are followed by all staff. Districts should develop and maintain documentation of their internal control system to clarify roles and responsibilities and thus create standards and expectations of performance and conduct.

Internal control is a process (affected by a district's school board, management, and other personnel) designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- reliability of financial reporting
- effectiveness and efficiency of operations
- compliance with applicable laws and regulations

It consists of five interrelated components:

- control environment
- risk assessment
- control activities

- information and communication
- monitoring

Each of these components of internal control is discussed below.

Control Environment

The control environment is established on the basis of the attitude of management toward internal control. AICPA Statement on Auditing Standards No. 78 states that the control environment “sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure”. As such, a management philosophy that is dedicated to establishing a sound business process and operating controls would tend to create a stronger internal control environment than a philosophy that is unaware of or unconcerned with internal controls. Collectively, various factors affect the control environment, including the following:

- integrity and ethical values
- commitment to competence
- school board’s participation
- management’s philosophy and operating style
- methods of assigning authority and responsibility
- the district’s organizational structure
- human resource policies and practices

The control environment reflects the overall attitude, awareness, and action of the school board, management, and other personnel concerning the importance of control and its emphasis in the district.

Risk Assessment

Risk assessment is the district’s identification and analysis of risks relevant to the achievement of its objectives. Risk assessment forms a basis for determining how risk should be managed. Risks can arise or change as a result of the following factors:

- changes in the operating environment
- new personnel
- new or revamped information systems
- rapid growth
- new technology
- new grant programs, building projects, or other activities
- organizational restructuring
- accounting pronouncements
- changes in federal regulations
- changes in finance-related statutes

Given the dynamic nature of governmental operating environments, the ability to anticipate and mitigate risks from these changes is a key factor in measuring the strength of internal controls.

Control Activities

Control activities are the policies and procedures that help ensure that management directives are carried out. School boards should adopt policies that are well written, followed by all employees and are reviewed periodically for any possible amendments. Control activities can be divided into four categories:

- performance reviews
- information processing

- physical controls
- segregation of duties

The application of control activities, such as the segregation of duties, is affected to some degree by the size of the district. A small district may have to implement other mitigating controls to offset the lack of segregation of duties.

Information and Communication

Information and communication represent the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.

Information systems encompass procedures and documents that perform the following functions:

- identify and record all valid transactions
- describe, on a timely basis, transactions in sufficient detail to permit proper classification for financial reporting
- measure the value of transactions in a manner that permits their proper recording in the financial statements
- permit the recording of transactions in the proper accounting period
- present properly the transactions and related disclosures in the financial statements

Senior management should deliver a clear message to employees about their responsibilities and roles in the internal control system. Employees should also have a means for communicating the effectiveness and efficiency of these systems to upper levels of management.

Monitoring

Monitoring is a process that assesses the quality of internal control performance over time. Ongoing monitoring activities include regular management and supervisory activities and other actions taken during the normal performance of management's duties. Furthermore, periodic reviews of internal controls and related activities, performed with internal personnel or external resources may be undertaken. The nature and timing of these evaluations depend on the effectiveness of ongoing activities and the risk that internal controls are not performing as intended by management. Deficiencies in the system of internal controls should be reported to the appropriate level of management.

Management should clearly assign responsibility and delegate authority with sufficient care to ensure that:

- persons who perform control procedures are held accountable for their performance by those who monitor these activities; and
- persons who monitor the performance of control procedures are held accountable by senior management or the school board.

If accounting information is routinely used in making operating decisions, management is likely to establish effective controls and hold lower level managers and employees accountable for performance. In addition, if management routinely uses accounting information to measure operating results, significant variances between planned and actual results are likely to be investigated. This review may detect the causes of the variances and effect the steps necessary to correct the procedures that failed to prevent them.

Common Types of Control Procedures

Numerous control procedures and monitoring activities are performed by individuals in governmental entities to accomplish particular objectives. All of these controls, however, can be classified within one of the following basic categories:

- access controls
- reconciliation and comparison of assets with records
- analytical reviews
- authorization and approval
- reviews of output
- transactional reviews, and
- general computer controls

Detailed control procedures or monitoring activities may be included in each of these categories, depending on the size of the entity and the sophistication of the particular control environment. Each of these categories is described below.

Access Controls

Certain controls prevent access to assets by unauthorized persons. Often these controls are physical in nature. For example, a district might store inventories of supplies and commodities in locked storage areas, store currency in a vault or a locked drawer, and use alarm systems to restrict access by unauthorized individuals. If controls to prevent unauthorized access to assets are not effective, assets may be lost or stolen. However, if detective control procedures (such as physical inventory counts) are appropriately performed, shortages should be discovered in a timely manner.

In some cases, unauthorized access to assets may be gained through vulnerable accounting records—especially records maintained on computer systems. For example, if warehouse requisitions can be issued through a computer terminal, access to inventory may be gained through the system. Controls over unauthorized access to assets through computer records may be physical (e.g., terminals may be kept in a locked room) or logical (e.g., access to the computer program or data files may be obtained only with the proper password or other user-identification method). Monitoring the control procedures that address unauthorized access includes observing physical control procedures, reviewing established access privileges with the manager of information systems, and reviewing reports of attempted computer access violations. Internal auditors often perform such activities.

Access controls, however, do not prevent individuals who have authorized access to assets from misappropriating them. Individuals who have authorized access to both assets and related accounting records may be in a position to conceal shortages of assets in the records. However, if duties are properly segregated, persons with access to assets will not have access to the related accounting records, which they might alter to conceal shortages.

Controls over authorized access to assets are important to a district, not only to prevent thefts, but also to ensure that assets are committed only after proper consideration by knowledgeable and experienced individuals. Authorization and approval are types of controls designed to prevent invalid or inappropriate transactions from occurring.

Reconciliation and Comparison of Assets With Records

Reconciling and comparing assets with accounting records establishes a system of independent verification, either through preparing an independent control document used to reconcile accounting records and assets or by directly comparing accounting records with related assets.

Examples of these procedures include the reconciliation of physical inventory with accounting records and the preparation of a bank reconciliation.

Analytical Reviews

The purpose of analytical reviews is to evaluate summarized information by comparing it with expected results. Management personnel often perform analytical reviews to determine whether the district is performing as planned. For example, a common analytical review procedure is the comparison of budgeted to actual performance, with investigation of any significant or material variances as determined by the analyst. Often, analytical reviews are used to monitor other underlying control procedures.

Authorization and Approval

Authorization and approval procedures prevent invalid transactions from occurring. Thus, this type of control typically involves authorization or approval of transactions at specific dollar thresholds and manual (e.g., requiring signatures of authorized individuals) or automated (e.g., password protected) authorizations for computerized transactions. The effectiveness of these procedures often depends on general computer controls over information security.

Reviews of Output

Reviews of output should be performed by school district personnel who have the knowledge and experience to identify errors. Such reviews are used to check the validity and accuracy of output by comparing it in detail with expected results.

Transactional Reviews

Transactional reviews check the validity and accuracy of transaction processing by comparing it in detail with expected results. Reviews often use exception reports (usually computer generated), which list items that could not be processed because they did not meet specified criteria. For example, a computer-generated check may be rejected if it exceeds some dollar amount and requires a manual signature. Monitoring these types of control procedures involves management reviews of results.

General Computer Controls

Computer systems frequently have common areas of control and related control procedures referred to as general computer controls. These controls directly or indirectly affect all systems that operate within a computer-processing environment. General computer controls include the usual elements of effective internal control (that is, an individual or group responsible for control procedures and monitoring activities). Managers of the information systems function usually monitor the performance of general computer controls. Monitoring activities include observation, exception reporting, reviews of work performed, reviews of program changes, oversight by information system steering committees, and the monitoring of user complaints. For example, the effectiveness of programmed control procedures, such as edit checks and approvals, depends on general computer controls that ensure that program changes are not made improperly. General computer controls include controls over computer operations; systems acquisition, development, and maintenance; information security; and information systems support, as detailed below:

- **Computer operations** - The computer operations staff is responsible for the day-to-day processing activities of the entity's system. It ensures that jobs are scheduled and processed as planned, data are properly stored on the system or tapes, and reports are distributed in a timely and accurate fashion.

- **Systems acquisition, development, and maintenance** - The systems acquisition, development, and maintenance staff is responsible for planning, acquiring (or developing), testing, and implementing new application systems and changes to existing application systems. Such controls are usually important in larger processing environments where there is more development and maintenance activity, where the systems are more complex, and where there is less reliance on purchased software.
- **Information security** - The information security function is responsible for administering and maintaining an entity's information security program, including both physical and logical security. The primary goal of such a program is to ensure that access (secure access and log-ins) to program data, online transactions, and other computing resources is restricted to authorized users.
- **Information systems support** - Information systems support includes system software maintenance, database administration, communications, and network management, and end user computing, as well as other functional groups with technical and administrative support responsibilities.

In the final analysis, maintaining the internal control environment and related control procedures is an integral part of management's responsibilities. In the context of governmental accounting and reporting, the control environment has a direct impact on a district's ability to collect and present accurate financial information.