



State of North Carolina

Department of State Treasurer

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Memorandum #1105

September 3, 2008

TO: Local Government Finance Officials and Their Independent Auditors

**FROM: Sharon Edmundson, Director
Fiscal Management Section**

SUBJECT: Audit and Reporting Tips for 2008

Based on our reviews of the 2007 audits and questions that are directed to our staff, the following are areas that we believe local government auditors and finance officials should review and which may impact the audit and preparation of financial statements for the fiscal year ended June 30, 2008.

Changes and Enhancements to Financial Statements

Debt Disclosures

In order to facilitate the Local Government Commission's (LGC) review of local government's debt issuance practices, preparers of the financial statements should include the following information in their debt disclosures: original issue date, original issue amount, terms of issuance, purpose of debt, and information regarding **the provider of funds**, particularly if funds were loaned by the State Revolving Fund or the US Department of Agriculture.

LGC records of outstanding debt (Form 129) are available online. Go to <http://www.nctreasurer.com>, select "State and Local Government" on the menu bar across the top of the page, then "Fiscal and Debt Management Information", and finally "[Annual Debt Payment Notices with 6-30-08 Balances](#)". An Adobe document will appear and you can use the "Search" function in Adobe Reader to find a specific unit of government. Please be advised that these records may not include all debt issued by a unit of government and will be updated after the fiscal year ends.

Risk Management Disclosures

Flood Insurance Disclosure

With the occurrences of flooding in recent years in various parts of North Carolina, flood risk management is a concern. If a local government has obtained flood insurance coverage, this information should be disclosed in the Risk Management note to the financial statements. If a local government has made the decision not to purchase insurance for risk of flood, this should be disclosed along with a brief discussion regarding the factors in that decision.

Fidelity Bonding of Finance Officer and Tax Collector

In order to allow our staff to monitor local unit compliance with the General Statutes, and to confirm that units have adequate amounts of bonding coverage, we are asking local governments to disclose in their risk management note **the dollar amount of bond** they carry on the finance officer position, the tax collector position, and the blanket bond held for individuals who handle or have in their custody more than \$100 of the unit's funds at anytime or who has access to inventories of the unit. If the unit is not in compliance with G.S. 159-29 for Local Government Finance Officers and G.S. 115C-441(a) for School Finance Officers, a statutory violation note should be added. Please note that the bonding requirement for School Finance Officers increased to a \$50,000 minimum at July 1, 2008.

Internal Balances and Transactions

Our office has observed instances of limited discussion in the internal balances and transactions note disclosures. Per GASB Statement 38 paragraph 14, the purpose of internal balances between funds should be reported. Per GASB Statement 38 paragraph 14, a general description of internal transactions and the intended purposes of significant transfers that do not occur on a routine basis or are inconsistent with the activities of the fund should be cited in the notes.

Statement Presentations

NC Education Lottery Revenues and Expenditures

Counties and local educational agencies first received lottery funds in the fiscal year ended June 30, 2007. Lottery revenues to local educational agencies (LEAs) should be presented in separate line items by project as illustrated in the Capital Outlay Fund of Carolina County Board of Education. The NC Department of Public Instructions (DPI) has instructed local school boards in its Program Report Code (PRC) 076 to track these revenues and expenditures in the School Capital Project Bond Fund. Further guidelines and other information on the accounting of the School Capital Project Bond Fund are available on the DPI's School Planning website, <http://www.schoolclearinghouse.org>. Based on communications with DPI lottery revenues that come into a county should reflect restricted intergovernmental revenue in the School Capital Projects Fund. The county should either reflect capital outlay expenditures made on behalf of LEAs or a transfer out to the General Fund/Debt Service Fund for the payment of school-related debt service payments. Carolina County portrays both scenarios. Additional information for counties regarding lottery revenues is available at the NC Association of County Commissioners' (ACC) website, www.ncacc.org. Please see Memorandum #1063 for a more complete discussion of lottery funding for school construction.

State 911 Board

Session law 2007-383 repealed Articles 1 and 2 of Chapter 62A and created Article 3 of Chapter 62A that created the State 911 Board. Under the new statutes revenues, received from the State 911 Board are restricted intergovernmental revenues to be held in a Special Revenue Fund called the Emergency Telephone System Fund. Effective January 1, 2008, unspent local 911 wireline fees held by local governments should have been transferred to their General Funds for unrestricted usage. Memoranda 1091 and 1096 provide more information. The City of Dogwood previously accounted for both the wireline and wireless 911 revenues in the Emergency Telephone System Fund. The City of Dogwood had \$4,304 of unspent wireline revenues that were transferred to the General Fund on December 31, 2007.

Video Programming Services Tax

Video Programming Services Tax is a new revenue from the State as a replacement to counties and cities for their loss of local cable franchise fees under the creation of a State cable franchising system under Article 42 of Chapter 66. The new revenue distributed in accordance with G.S. 105-164.44I should be treated as unrestricted intergovernmental revenue.

Solid Waste Disposal Tax Fees, Remittance and Revenues

The Solid Waste Disposal Tax authorized by Article 5G of General Statute Chapter 105 (187.60 through .63) can affect local governments in two different ways. The first part affects your local government if it is considered an operator of a landfill and/or transfer station. The second part specifies the revenues to be disbursed to counties and municipalities.

G.S. 105-187.61 sets the tax on disposal of municipal solid waste and construction and demolition debris in any landfill permitted pursuant to Article 9 of Chapter 130A of the General Statutes at a rate of two dollars (\$2.00) per ton of waste. Per the staff at the Department of Revenue, the Statute states the owner or operator **may** pass along the charge to the third parties making use of the landfill, but does not require that they do so. We believe that most local government landfill operators will choose to pass the tax along to their users. This charge (user fee) should be recorded as a revenue. Regardless of the unit's choice to collect or not collect the fee from its users, the tax of \$2 per ton of waste must be paid. The amounts paid to the Department of Revenue should be recorded as an expense and/or expenditure. This tax must be remitted to the Department of Revenue monthly in a manner similar to the remittance of sales tax.

The disbursement piece of this legislation (G.S. 105-187.63) dictates that the fees collected and remitted to the Department of Revenue will be disbursed in the following manner, after costs of collections are deducted:

- 50% to the Inactive Hazardous Sites Cleanup Fund
- 18.75% to cities
- 18.75% to counties
- 12.5% to the Solid Waste Management Trust Fund

Funds will be distributed on a per capita basis and are restricted for use to fund solid waste management programs and services. For purposes of this legislation residents of municipalities are not included in the population total of the county or counties in which the municipality is located.

Since the City of Dogwood does not operate or own a landfill or transfer station, the General Fund reflects this new revenue in the restricted intergovernmental section. Carolina County has a Landfill Fund to account for the operation, maintenance, and development of various landfills and disposal sites. The County's Landfill Fund has been updated to reflect the fee, remittance, and revenue transactions.

Medicare Hold Harmless and Article 46 Sales Tax or Land Tax

As discussed in Memorandum #1091, the State has begun to take-over 100% of non-federal Medicaid services expense from the counties. In return, cities and counties will forgo the one-quarter cent Article 44 sales tax revenue starting on October 1, 2008. While the State begins to take over the aforementioned services, counties will notice their Public School Building Capital Funds (ADM) reduced. Based on comparative revenue levels, counties may be entitled to a Medicare Hold Harmless payment to be accounted for with the Local Option Sales Tax revenue in the General Fund. The General Assembly also gave counties the authority to levy either a new Article 46 one-quarter cent sales tax or 0.4 percent land transfer tax, subject to voter approval. The counties are not obligated to allocate a portion of these new revenues to municipalities. Carolina County has adopted the Article 46 sales tax and receives a Medicaid Hold Harmless payment. Per the NC Association of County Commissioners (NCACC), Medicaid Hold Harmless payments should be separately reported in the detailed

budget to actual schedules of the General Fund. The NCACC's website provides additional helpful information at www.ncacc.org. Also, the August payment of the hold harmless funds is the "settle up" payment for the previous fiscal year. It is not subject to appropriation by the General Assembly and therefore should be accrued in the financial statements.

Pledged Revenues

GASB Statement 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, provides guidance on determining if a transaction is a sale or a collateralized borrowing; states that intra-entity transfers of assets should be reported at carrying value of the transferor; and provides guidance on the required disclosures for all debt that is backed by a specific revenue source when that revenue source is not the entity's predominate source of revenue. The City of Dogwood has issued revenue bonds for the Water and Sewer Fund with the understanding that the debt payments will be paid from water and sewer revenues. The revenue bond note disclosure has been expanded with the additional disclosure required.

State Firemen's Association Address Change

Previously in Farmville, the State Firemen's Association new mailing address is now 323 West Jones Street, Suite 401, Raleigh, North Carolina 27603.

Increase in Register of Deed's Pension and Decrease in Contributory Rate

Session Law 2007-245 increased the maximum monthly pension payable to eligible Register of Deeds retirees from \$1,200 to \$1,500 (not to exceed 75% of the employee's equivalent annual salary immediately preceding retirement, including any and all supplements). The session law also reduced the percentage of payroll that counties remit to the State Treasurer for the Registers of Deeds' Supplemental Pension Fund from 4.5 to 1.5%. Carolina County's pension note disclosure on the Registers of Deeds' Supplemental Pension Fund has been update.

Other Issues of Interest that May Affect Audited Financial Statements

Payroll Deficiencies

As we have discussed in several memoranda, timely and accurate preparation and recording of payroll expenditures and liabilities continues to be a challenge for some of our local units of government. Units of government with material penalty and interest liabilities or expenditures relating to payroll should expect to see a significant deficiency or material weakness in their internal control reports. Units of government that are not in compliance with IRS regulations regarding the reporting requirements for various personnel (1099 in lieu of W-2 reporting) should expect to see findings in their internal control reports and their stewardship and compliance note disclosures. Please see memorandums #1079, 1083, 1084, and 1089 for a more complete discussion of these issues.

Stewardship and Compliance Note Disclosures

In the course of our reviews of local government audits, we sometimes see reports that contain findings in the internal control reports that are not disclosed in the notes and vice versa. Statement preparers and auditors should take care that the statutory violations that may be noted in the stewardship and compliance note are consistent with the findings in the internal control reports. Conversely, findings in the internal control reports that involve statutory violations should be noted in the stewardship and compliance note disclosures.

On a related note, our office continues to see stewardship violations on the line-item or department level when the budget note was adopted at the department or function level. The violation should be noted at the same level that the budgetary control was established.

Fund Balance Appropriated

Over the last year our staff noted several instances in which the unit budgeted appropriated fund balance in excess of the statutory limitation in both governmental and enterprise funds. According to G.S. 159-13(b)(16), appropriated fund balance in a fund shall not exceed the sum of cash and investments minus the sum of liabilities, encumbrances, and deferred revenues arising from cash receipts, as those figures stand at the close of the fiscal year next preceding the budget year. If a unit has overappropriated fund balance, then a note should be added for this statutory violation. Our office has noted several instances where budgets reported fund balance appropriated as a source but no fund balance was actually appropriated due to an offsetting contingency. Please remember that budgets should project estimated revenues and appropriations, then use either appropriated fund balance or a contingency to balance the budget. Further more, the amount of appropriated fund balance is limited to the fund balance available (FBA) calculated for the prior fiscal year (for example, the fiscal year 2008-2009 is limited to the FBA as of June 30, 2008) and the contingency is limited to 5% of all other appropriations (G.S. 159-13(b)(3)).

SAS 112 Deficiencies

Our office expects the use of a more narrow interpretation on SAS 112 for the fiscal year ended June 30, 2008. Units with limited staff should expect to have at least a significant deficiency. Units with prior period adjustments recommended by the auditor should expect to have at least a significant deficiency. Findings do not necessarily require that changes be made. Units should take steps to mitigate findings. However, some units may decide that it is not cost effective to eliminate findings. Please see memoranda #1070, 1077, 1080, and 1096 for a more complete discussion of these issues.

Statutory Violations and the Audited Financial Statements

In the course of our reviews we continue to see instances of audited financial statements reflecting budget violations which are then noted in a unit letter to the unit's elected officials. After receiving the letter, at times the local government reports back to us with evidence that the budget had in fact been amended and that no violation occurred. We encourage our local governments to review carefully the budget to actual schedules and statements in the audited financial statements and be aware of any violations noted.

In a related observation, at times the budget note does not agree with the budget presentation in the audit report. We have noticed several instances of the note saying the budget was adopted at the function level but the auditor included in the Stewardship note budget violations at the department or line-item level. Budget violations in the Stewardship note should be at the same level that the budget was adopted.

Chart of Accounts Changes for Boards of Education

There have been significant changes in the approved chart of accounts for Boards of Education's functional codes and classifications. The GASB 34 revenue allocation and conversion worksheets on our website have been updated. Since the "other" function expenditures have been removed from the two major purpose codes, there is no longer a need for the salary and benefits allocation worksheet. Carolina County Board of Education's financial statements have been updated to coincide with the updated functional codes. Due to significant changes in the coding of the Chart of Accounts, comparative data in the Condensed Statement of Activities of the Management Discussion and Analysis will not need to be restated under the new function expenses. The Governmental Finance Officers Association has agreed to accept this presentation as long as the specific explanation for the non-comparability is included in the related analysis paragraph. Also, the presentation of capital outlay expenditures in the Capital Outlay Fund will be different than previous years. Under the new purpose codes, the "capital outlay" functions should not include any costs which may be coded to one or more specific purpose functions. Under the previous codes, capital outlay expenditures appeared as one line-item group, broken down to type of capital asset. This distinction is no longer applicable.

Charter Schools and Construction Projects

In past years charter schools have not typically needed to use capital project funds to account for capital expenditures. However, if a charter school is undertaking a facility construction project, it should account for this in a capital project fund per generally accepted accounting standards. Routine capital outlay can continue to be accounted for in the General Fund.

LGC Review of Drafts of Audited Financial Statements

Due to staff limitations, the LGC staff will review only drafts of audited financial statements that are camera ready Comprehensive Annual Financial Reports, or drafts of audited financial statements for governments that have a scheduled debt sale requiring the preparation of an official statement.

Submission of Audit Reports of Municipalities to the State 911 Board

To facilitate compliance with G.S. 62A-46(e)(3), the LGC now requires municipalities that have participating PSAPs (public safety answering points) to submit an additional copy of their annual audit report, effective for June 30, 2008 fiscal year audits. The LGC will forward the extra copy to the State 911 Board upon review and approval of the audit. Audit submission requirements for other government types - counties, schools, public authorities, etc., have not changed. Please see Memorandum #1091 for a more complete discussion of this issue.

Retirement Contribution Rates for TSERS, Firemen's and Rescue Squad Workers

Below are the retirement funding rates as of June 30, 2008, for the above mentioned retirement systems. Governments with employees that are members of these retirement systems will need this information for their June 30, 2008, pension note disclosures.

TSERS (Teachers and State Employees Retirement System)

Retirement contribution:	3.05%
Retiree Health Reserve	4.10%
Death Benefit	0.16%
Disability	<u>0.52%</u>
Total	7.83%

Firemen and Rescue Squad Workers Retirement System

Firemen's Retirement	\$256.61
Rescue Squad Workers' Retirement	\$179.99

GASB Statement 40 Note Disclosure Information

STIF	Weighted average maturity of 2.9 years
NCCMT	Term portfolio duration of 0.8 year and rating of AAAM

If you have any questions, please contact members of our staff at 919-807-2381.