



State of North Carolina

Department of State Treasurer

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*State and Local Government Finance Division
and the Local Government Commission*

Memorandum #970

July 10, 2002

To: Finance Officers of Counties, Municipalities, Boards of Education, Public Authorities, and Certified Public Accountants

From: T. Vance Holloman, Director
Fiscal Management Section

Subject: Single Audit and Yellow Book Issues for the Fiscal Year Ending June 30, 2002

The following is a discussion of issues concerning local governments and public authorities that are required to have federal or State single audits or audits conducted under Governmental Auditing Standards only for year ending June 30, 2002. A more inclusive discussion of federal and State single audit issues can be found in Section 35-E of the *Audit Manual for Governmental Auditors in North Carolina*.

Yellow Book Reports Amendment #3

The General Accounting Office (GAO) issued Amendment No. 3 to the Yellow Book, Auditor Independence, which significantly changes the requirements on Independence. The GAO Independence Standard establishes independent standards that expands the definition of personal impairments and acknowledges the ways audit organizations can be free of organizational impairments to independence. GAO employs a principle-based and safeguard approach to independence.

Two overarching principles auditors are to consider before agreeing to perform nonaudit services for a client that they audit: 1) Audit organizations should not provide nonaudit services that involve performing management functions or making management decisions; 2) Audit organizations should not audit their own work or provide nonaudit services in situations where the nonaudit services are significant /material to the subject matter of the audits (paragraph 3.21). Additionally, seven safeguards must be followed if the audit organization performs nonaudit services that do not violate the two overarching principles. For example: the audit organization should preclude personnel who provide the nonaudit services from planning, conducting, or reviewing audit work related to the nonaudit services. The scope of the audit cannot be reduced beyond the level that would be appropriate if the nonaudit work was performed by another unrelated party and, certain documentation and quality assurance requirements must be met.

The GAO Independence Standard includes specific examples of nonaudit services that are permitted as long as the auditor complies with the principles and safeguards. The Standard also expressly prohibits certain nonaudit services. Among the permitted services are proposing, adjusting and correcting entries that are identified during the audit as long as management makes the decision to accept these entries; and preparing a units indirect cost proposal or cost allocation plan, provided management has taken responsibility for all significant assumptions and data. (The Office of Management and Budget's policy, as stated in Circular A-133, prohibits auditors from performing federal single audits when the indirect cost recovered by the auditee during the period exceeds \$1 million.) The audit organization cannot post transactions, whether coded or not coded, to the entity's financial records or to other records that subsequently provide data to the entity's financial record.

The new standard is effective for audits years beginning on or after October 1, 2002. This applies to year-ends of June 30, 2004 for most North Carolina governmental units. The GAO encourages early implementation. Due to concerns the industry has regarding the new standard, the GAO issued a question and answer guide in July 2002. The LGC will work with local governments and CPAs to determine how this will impact North Carolina governments.

Changes are proposed to the other standards of the Yellow Book. According to GAO, these additional revised standards will hopefully be out no later than December 2002. Copies of the new standard and the question and answer guide may be obtained at GAO www.gao.gov/govaud/ybk01.htm (there is a link from N. C. State Treasurer's single audit resources web-page).

Hurricane Floyd Relief Funds

The Department of Commerce is no longer distributing money for Hurricane Relief. Crime Control and Public Safety is now handling those funds through their existing programs. Although most of the funds were distributed to locals during the year ending June 30, 2001, some units may have received funding for year-end June 30, 2002.

Recipients of CDBG Awards and DENR Grants and Loans

Occasionally local governments agree to expend local funds for Community Development Block Grant (CDBG) projects with federal awards passed through from the N.C. Department of Commerce, Division of Community Assistance (DCA). The Special Revenue Fund or a Capital Project Fund that reports these projects should include any local funds for the project. The local funds would be reported as other financing sources, operating transfers from the fund that the local money came from (i.e., general fund, capital reserve fund). DCA requires these local moneys reported so as to properly close out the project. These funds should be reported on the Schedule of Expenditures of Federal and State Awards if a column for local expenditures is included.

New loans and grants for construction projects from the N. C. Department of Environmental and Natural Resources should be budgeted in a multi-year project ordinance and should be presented in the audit reports as such. The condition has been added to the LGC 108A form that is submitted with all federal and State loan applications with DENR. A copy of the project ordinance must be submitted with the first reimbursement request.

County Grants for School Capital Outlay

Public School Building Bond Funds – The Public School Building Bond Act of 1996 identifies these funds as grants to counties. Public School Building Capital Funds – The Office of Management and Budget from the Governor’s Office administers these funds. The funds are grants to the county according to G.S. 115C-546.1. **Therefore, if the expenditures are handled by the board of education, the county is required to treat these funds as pass through to the school.** County governments should report both revenues and expenditures for these funds in the financial statements as well. The County’s Annual Financial Information Report (AFIR) information must reconcile to the County’s audit report. The information on School Capital Outlay is taken from the audit reports and included in Report on County Spending on Public School Capital Outlay which is issued to the General Assembly as required by G.S. 115C-440.1.

SAS 93 Omnibus Statement

Among the topics covered in the statement was an amendment to SAS 58 *Reports on the Audited Financial Statements*. The American Institute of Certified Public Accountant (AICPA) is changing the wording of auditor’s reports to reflect the country of origin of the auditing standards under which the audit was conducted. This would include the independent auditor’s report and compliance reports (yellow book report and single audit). With the advent of the Internet it is possible that a user in another country may read financial statements prepared in the United States. Please refer to the Audit Manual for samples.

Questioned Costs

Occasionally, the auditor will list a compliance finding and cite the questioned costs as “none” or “undeterminable.” Although it is understandable that questioned costs cannot be determined in certain findings of noncompliance, an explanation as to why is necessary. Funding agencies need this information to adequately make a management decision. The LGC will reject single audit reports that have compliance findings and either no questioned costs amount is provided or there is no explanation as to why the finding had no questioned costs. OMB Circular A-133 §__510(a)(3) states that “Known questioned costs that are greater than \$10,000 for a type of compliance requirement for a major program” shall be reported as a finding.

Mental Health, Developmental Disabilities, and Substance Abuse Services Issues

Implementation of New Cost Matrix and Enhanced Compliance Enforcement: Each year the State requires area mental health programs to submit Cost Finding reports. For the first time this year, private providers of mental health services have had to submit this report as well. These cost reports indicate to the State the costs of providing various units of mental health services to mental health clients throughout the State.

In the DHHS Controller's Office 2001 review of the Area Mental Health Programs' Cost Finding cost reports, the Controller's Office found that the audits of these agencies were not supporting the expenditure figures included in the Cost Finding Report. The data provided in these Cost Finding reports is the basis to establish Pioneer, MR/MI, Comprehensive Service Treatment Program, and Y-code Medicaid rates for the following fiscal year. With the focus of recent legislature on area mental health reform, capitation of administrative costs, and consistency in

reporting, it is even more imperative that audits support the Cost Finding report data. The Cost Finding report as well as the Area Mental Health Program audits should be in accordance with the Department of State Treasurer's chart of accounts. In particular, the personnel figures (1xx line items) as well as the Contracts for Direct Service (6xx line items) should agree between the Cost Finding report and the audit. It is mandatory for the fiscal year 2002-2003 reporting year, with the incorporation of the new matrix and the progression of implementation of the Mental Health Bill (House Bill 381) that the Cost Finding Report and audit figures agree.

With the full implementation of the cost matrix for the 2003 report year, it will be required that the county audit supporting the cost finding, fully comply with the cost matrix as well as fully support the cost figures within the cost finding. In order for you to understand better the scope of the cost finding review, set forth below are issues identified during June 30, 2001's cost finding.

The issues discovered with the 2001 cost finding are:

- ✓ The 1xx to 8xx line items on the audit did not coincide with the 1xx to 8xx figures in the cost finding.
- ✓ In some situations the total costs per the audit did not match the total cost figures for the audit.
- ✓ There were also issues with the audit's break out of expenditures by cost center that did not reflect the same information provided in the cost finding report.
- ✓ Not all items were able to be crosswalked between the audit and the cost finding report

Should any of these items occur with the 2003 cost finding, the area program will be required to have either the cost finding or the audit changed so that both items are in sync.

The matrix is available through the DHHS Controller's Office web page (<http://www.dhhs.state.nc.us/control/>) under Area Mental Health Authorities item. If you should have questions regarding the matrix, the DHHS Controller's Office Rate Setting staff can be reached at 919-715-8189 or 715-8190 or 715-8188."

Subrecipients of the Area Mental Health Programs: Pass through entities are required to identify the total amounts provided to subrecipients for each federal or State program in the schedule of expenditures of federal and State awards (OMB A-133 §___.310(5)). This is preferred to be reported as a note to the schedule and should be reported "to the extent practical." Information included should be the program title, CFDA number, federal award amounts provided to subrecipients, and State award amounts provided to subrecipients. Proper presentation of subrecipient identification reported as notes to the schedule can be found in Carolina County, NC's Schedule of Expenditures of Federal and State Awards on page 35-E-5.7. The AICPA in Statement of Position 98-3, Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards, states that if a pass-through entity is unable to identify amounts provided to subrecipients, the auditor should consider whether a reportable condition should be reported and if a material noncompliance finding has occurred.

Division of Medical Assistance (DMA) Medicaid Settlement Payments: Area Mental Health Programs received Medicaid settlement payments from DHHS Controller's Office for the Federal share during fiscal year 2002. These payments were for settlements for the State's fiscal year ending June 30, 2000. The Division of Mental Health, Developmental Disabilities, and

Substance Abuse Services (DMHDDSAS) instructed Area Programs to “place the full amount of this settlement payment in your fund balance until issues regarding the level of fund balance are resolved.” The question concerning the use of these funds was whether the multi-county area programs’ fund balance available percentages was 8% or greater at June 30, 2000. This percentage is the minimum amount recommended by the Local Government Commission, which is one month (1/12) worth of expenditures.

The LGC has received some inquiries on how to treat the settlement payments given the instructions from DMHDDSAS. Our office’s understanding is that this is a gain contingency. Area programs were not aware of the settlement and receipt of these revenues was not anticipated. Amounts could not be measured or the availability determined at June 30, 2000. So no receivable or deferred revenue was recorded at June 30, 2000 (or June 30, 2001) by area programs. The settlement payments are subject to the Local Budget and Fiscal Control Act, therefore the area program’s budget should have been amended to account for the receipt of these funds. To have the settlement payments to support the fund balance available percentage, as instructed by DMHDDSAS, would require the area program to adhere to their budget. No designation of fund balance is necessary nor do generally accepted accounting principles allow restricting fund balance for the amount of payment. The State of North Carolina has recognized the receipt of this as revenue for the year-ending June 30, 2002. Revenue should have been credited upon receipt of the settlement payments by area programs. Since no appropriation would have been budgeted, cash from the settlement payment would add to the fund balance available percentage.

FYE 2002 Confirmation Reports from DHHS

The N. C. Department of Health and Human Services (DHHS) Controller’s Office is again preparing to make all reports that supply auditors with an independent confirmation of the financial assistance provided to certain units of government available on the Controller’s website at the following URL: <http://www.dhhs.state.nc.us/control/>. Since these reports may be accessed and printed from this website, DHHS will not routinely mail hardcopies to users. For SFY 2001, DHHS continued to receive confirmation requests from many CPAs and their local government clients even though the confirmation reports were available on our website. We encourage you to obtain these reports online and save the cost of generating and mailing confirmation letters. For those report users who do not have Internet access, please refer to the 2002 Compliance Supplement for the address to which confirmation letters should be mailed. The DHHS Controller’s Office target date for the reports to be available on the website is August 30, 2002. **The LGC has prepared Excel spreadsheets that will provide assistance in preparing the Schedule of Expenditures of Federal and State Awards for Subsidized Childcare, Mental Health, Developmental Disabilities, and Substance Abuse Service Programs, and Public Health Programs.** Included are instructions, a spreadsheet for data entry, and a spreadsheet that displays the proper presentation. Modifications may be necessary by the user for a particular unit of government. The DHHS Controller’s Office generates various confirmation reports and related Keys to Account Codes (when required), all of which may be accessed at the website, as follows:

SUBSIDIZED CHILD CARE PROGRAMS: These funds are reimbursements from the DHHS/Division of Child Development and are reported on the LISTPAY1 and LISTPAY2

reports for Child Care. To determine the program title, CFDA number, or category (federal or State dollars), the user must have a copy of the LISTPAY2 report and the Key to Account Codes.

MENTAL HEALTH, DEVELOPMENTAL DISABILITIES, SUBSTANCE ABUSE SERVICES: The DHR-DAPG87-AP-ONLY (REPORT 04) reports the annual allocation payments made to the area mental health programs by the DHHS/Division of Mental Health/Developmental Disabilities/Substance Abuse Services based on both UCR (Unit Cost Reimbursement) and non-UCR activities. UCR payments are based on predetermined rates for MH/DD/SA services provided by the units. These rates, set by the DHHS Controller's Office, are based on the most recent actual cost finding. The number of services provided by the unit multiplied by the appropriate rate calculates the amount of reimbursement that has been "earned". Non-UCR payments are based on anticipated expenditures. A settlement process occurs after year-end to compare the payments as reported on the REPORT04 to the actual earnings for UCR payments and actual costs for the non-UCR payments. The REPORT04, when used in conjunction with the Key to Account Codes, identifies the federal and State programs, CFDA numbers, and amounts distributed to the unit. The user must have a copy of the Key to Account Codes.

The Schedule of Expenditures of Federal and State Awards reports expenditures and the REPORT04 reports revenues. Adjustments to the REPORT04 amounts are needed by the preparer to reflect the actual expenditures. In some cases the unit will expend all funds received from DHHS. In this case, the amounts on the Schedule of Expenditures and the REPORT04 will be the same. In other cases the two amounts may not be materially different. During the Single Audit Review process, the REPORT04 is used by the LGC to determine if amounts contained in the audit reports are materially correct and that the clusters are presented as required by DHHS.

PUBLIC HEALTH PROGRAMS: For programs administered by the DHHS/Division of Public Health, the Report LISTPAY2 details reimbursements to local and district health departments for certain activities. The LISTPAY2 identifies the federal and State awards, CFDA title and numbers, and amounts distributed to the local and district health departments. The user must have a copy of the Key to Account Codes to use in conjunction with this report.

Special Supplemental Nutrition Program for Women, Infants and Children (WIC) Direct Benefit Payments (DBP) are reported on the WIC Yearly Food Instrument Expenditure Report.

SOCIAL SERVICES PROGRAMS: The DHHS/Division of Social Services (DSS) reports funding to counties on the WC302 report entitled "Participation in Budgeted County Expenditures". This report provides the total amounts distributed by DSS (amounts received by the counties) between July 1, 20X1 to June 30, 20X2 of a fiscal year. Since these are reimbursements by DSS for the period June 1, 20X1 (of the prior period) to May 31, 20X2 (of the current period), adjustments are needed to the WC302 in order to reflect actual costs. The XS335 report shows amounts of monthly distributions to local DSS programs. By adding the June 20X2 XS335 amounts (payments for reimbursements from DHHS for June 20X2) and deducting the June 20X1 amounts (reimbursements for June 20X1) to the WC302, the preparer of the schedule of awards or the auditor can obtain amounts that reflect actual costs.

The WC302 reports administrative expenditures for each program and benefit payments paid directly, referred to as Income Maintenance. Items listed under County Admin. Adjustments,

such as State Aid to Counties, are not financial assistance and should not be reported on the Schedule of Expenditures of Federal and State Awards. DSS programs that are located on the WC302 are: Work First/TANF (Admin. and DBP), N.C. Child Support Enforcement (Admin.), Low Income Energy Assistance (Admin. and DBP), Crisis Intervention Program (Admin. and DBP), Permanency Planning-Families for Kids (Admin.), Adoption Assistance Program (Admin. and DBP), Foster Care and Adoption Cluster (Admin. and DBP), Foster Care-Title IV E (DBP), State In Home Services (Admin.), Adult Day Care (Admin.), SSBG for other services and training (Admin.), LINKS (Admin.), Health Choice (Admin.), and Medicaid (Admin.).

Food Stamp DBP reports the amounts expended for Food Stamps for each of the twelve periods on the Monthly EBT Issuance Report.

No Key to Account Codes is necessary for DSS programs because the CFDA numbers and other pertinent information are provided on the confirmation reports.

OTHER REPORTS FOR DHHS PROGRAMS: Medicaid DBPs (administered by the DHHS/Division of Medical Assistance) are reported on the WD667 and the MS666R reports. Councils of Government and a few counties utilize certain reports to confirm payments received from the DHHS/Division of Aging for programs to benefit citizens who are 60 years of age or older and from the DHHS/Division of Facility Services for the Regional Emergency Medical Services System Development (EMS) program. No Key to Account Codes is necessary for these programs because the CFDA numbers and other pertinent information are provided on the confirmation reports.

Most Common Single Audit Deficiencies for Fiscal Year Ended June 30, 2001

Cluster of Programs

- 1) Cluster(s) of programs were not audited as a major program. (Refer to discussion on Cluster of Programs, page 5 of this memo and Audit Manual page 35-E-1.6.)
- 2) Cluster(s) of programs were not properly listed as major program(s) in the ID of major programs section of the Summary of Auditor's Results. Please refer to Identification of Federal (or State) Programs on page 8, #2 for an explanation.

Subrecipients Identification

- 1) Amounts provided to subrecipients were not listed on the Schedule of Expenditures of Federal and State Awards. (Refer to discussion on Subrecipients Identification, Audit Manual page 35-E-1.7(c).)

Financial Opinion

- 1) The auditor's report did not reference that the accompanying Schedule of Expenditures of Federal and State Awards as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Yellow Book Report

- 1) Management letter referenced immaterial compliance findings, but the management letter was not referenced in the compliance section of the report.

Section III Federal Awards and Section IV State Awards Findings and Questioned Costs

- 1) Questioned costs were not given and there was no explanation as to why the finding resulted in no questioned costs.

Corrective Action Plan

- 1) Corrective Action Plan was not included for Yellow Book findings.
- 2) Corrective Action Plan did not contain the name(s) of the contact person(s) responsible for corrective action and the anticipated completion date. (Refer to Section 315(c) of OMB 133 and page 2 of this memo).

Identification of Federal (or State) Programs

- 1) Program(s) that are listed as (a) major program(s) in the Summary of Auditor's Results, Schedule of Findings and Questioned Costs should have the same program name as presented on the Schedule of Expenditures of Federal and State Awards.
- 2) Cluster(s) of Programs should be presented by cluster name and corresponding CFDA's for the programs listed. If the cluster is not presented properly on the Schedule of Expenditures of Federal and State Awards, all programs associated with the cluster should be listed within the ID of Federal (or State) Programs.

Data Collection Forms

- 1) Copy of data collection form was not received.

The LGC has issued memoranda addressing yellow book and single audit issues as follows:

#950	Single Audit Issues for the Fiscal Year Ending June 30, 2001.....	8/02/01
#918	Single Audit and Yellow Book Issues for the Fiscal Year Ending June 30, 2000.....	6/16/00
#898	Amendments to <u>Governmental Auditing Standards</u> (Yellow Book)...	10/21/99
#882	Single Audit Issues for the Fiscal Year Ending June 30, 1999.....	5/11/99
#855	Single Audit Issues for the Fiscal Year Ended 6/30/97.....	7/22/97
#854	Audits Performed Under the Yellow Book.....	7/23/97
Misc.	Single Audit Issues Related to Benefit Payments.....	7/07/97
#845	Audit Requirements for the Fiscal Year Ended 6/30/97.....	2/11/97

These memos along with other yellow book and single audit resources can be obtained from the N. C. Department of State Treasurer's Web page at: <http://www.treasurer.state.nc.us>, by scrolling down to single audit issues in "select a topic box."

If you have any questions relating to these issues, contact Jim Burke at (919) 807-2383, 807-2398 (fax), or james.burke@treasurer.state.nc.us.