

## **Governmental Audit Program for North Carolina Local Government Budget and Fiscal Control Act**

The audit program below is provided as a supplement to other audit programs which already address compliance with generally accepted accounting principles or federal programs. This audit program suggests procedures within the context of the North Carolina Local Government Budget and Fiscal Control Act (LGBFCA). This program should aid the auditor in identifying items that may be violations of State law or evidence of internal control weaknesses. Many of the steps and procedures below are interrelated and may be done in conjunction with other audit procedures. Please read the suggested procedures before beginning the audit work. Please note also that the LGBFCA is applicable to units of local government, and public authorities. References to “the unit” or “the local government” are not meant to, and do not, exclude public authorities, or auditors of public authorities, from using the following suggested audit procedures. [There are special provision of 159 that apply to Public Hospitals \(G.S. 159-39\), Municipal Power Agencies and Joint Municipal Assistance Agencies \(G.S. 159-41\) and Public Housing Authorities \(G.S. 159-42\).](#) This audit program is not intended to be all inclusive; professional judgement should be used in determining the extent of tests and the use of procedures not included herein. A full understanding of the LGBFCA is essential to a thorough audit of a local government or public authority in North Carolina. A copy of the LGBFCA may be ordered from the Institute of Government. See page 5-B-7 for order information. The General Statutes of North Carolina are also available on the web site of the North Carolina General Assembly, [www.ncga.state.nc.us/](http://www.ncga.state.nc.us/).

- A. **BUDGET** - This section *suggests audit procedures* for examining the methods used by the unit of local government or public authority to develop and adopt the budget ordinance for the audit year. Subsequent amendments to the budget should also be tested. These audit procedures focus on specific North Carolina budget requirements.

**Obtain a copy of the adopted budget ordinance of the unit, including any budget amendments.**

1. Foot the original budget ordinance to test that the estimated revenues and appropriated fund balance are equal to the appropriations. Test that all the amendments to the original budget maintain the balance established by the original budget ordinance. [Consider the use of a spreadsheet program to list the original budget and subsequent amendments. This will verify both the footing and crossfooting of the final budget. Consider also reviewing at this point G.S. 159-13, detailing the form and required elements of the budget ordinance.]
2. Test the budget ordinance and amendments for the following attributes related to the property tax levy.
  - a. Check that the original budget ordinance includes the property tax levy.

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b. Check that none of the budget amendments change the actual tax levy unless it met exceptions as outlined in G.S. 159-15.

c. Compare the estimated property tax collection rate in the adopted budget ordinance and any amendments to the estimated tax collection rate. Check that the estimated collection rate used in the adopted budget ordinance does not exceed the actual property tax collection rate, as reported in the prior year's audit.

d. For budgets adopted after July 1, 1999, test that the estimated tax collection for motor vehicles was properly limited per G.S. 159-13(b)(6).

i. Review workpapers from the budget officer and the county tax office, verifying that the estimated collection percentage for motor vehicles is based upon the motor vehicle taxes added to the levy for July through March.

ii. Observe, and recalculate if possible, that the collections against this nine month period of tax levy is based on twelve months worth of collections, ending on June 30.

iii. Verify that the estimated tax collection rate of motor vehicle property tax in the budget ordinance did not exceed the actual tax collection rate for the nine month period in the preceding fiscal year.

iv. Verify that the estimated collection rate for all other property does not exceed the actual collection rate from the prior fiscal year.

e. If unit had a property tax re-valuation, did unit include revenue-neutral tax rate in the budget message?

3. Test the final amount of fund balance appropriated. (See the Appendix A for assistance in recalculating fund balance available.) Verify that the final amount of fund balance appropriated did not exceed the fund balance available at the end of the prior fiscal year.

4. Observe the approved budget ordinance to ensure that the appropriations have been made in accordance with the LGBFCA.

a. Appropriations should be by function, department, or project (G.S. 159-13(a)). Check that estimated revenues are presented by major source. [Consider checking at this point that the notes to the financial statements will disclose the correct level of budget adoption. Consider also checking that the audit report will include budget to

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actual statements at least at the level of legal compliance, i.e. at the level the budget was adopted.]

b. After all audit adjusting entries have been made, check that no overexpenditures have occurred at the level of budget adoption. If such overexpenditures have occurred, they should be disclosed in the Stewardship and Compliance section of the notes to the financial statements. [If the unit maintains a line item budget for daily managerial purposes, consider if there are material over/under expenditures in line items. While a statutory violation may not have occurred, a condition may exist which should be disclosed in a management letter.]

5. Test the following attributes for the “Contingency” appropriation (if applicable).

a. Review the original appropriations for contingencies, and the final appropriation for changes.

b. Recalculate the final contingency appropriation and verify that it does not exceed the limit defined by State statutes. (See Appendix B for a “form” for this recalculation.)

c. Check all funds/departments with appropriations for contingencies. Verify that no expenditures have been directly charged against contingencies.

d. Review the board minutes for resolutions which affect the appropriations for contingencies. The budget resolution should be treated as an amendment to the budget. Trace from the resolution to the final budget, to verify that appropriations for the proper functions or departments were increased and that the contingency appropriation was appropriately reduced.

6. COUNTIES ONLY Review the appropriations to the school administrative units. If the appropriation was reduced from the original budget ordinance during the year, confirm that the board of education agreed by resolution to the reduction [or County met the requirements of G.S. 159-13\(b\) 9.](#)

7. INTERNAL SERVICE FUNDS If the local government operates internal service funds, review the budget ordinance for inclusion of a balanced financial plan(s).

8. Review the minutes of the governing board’s meetings for the following items. [Note that other suggested audit procedures often include the minutes of the governing board. **Review those procedures to ensure that one reading/review of the minutes is efficient and effective.**

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- a. Verify that a budget officer has been appointed in the minutes, if the unit does not have the manager form of government..
  - b. Verify that a public hearing on the budget was held.
  - c. Verify that the budget ordinance was adopted by July 1.
  - d. Verify that at least 10 days did pass between when the budget and the budget message were presented to the board and the adoption of the budget by the board.
  - e. If the budget ordinance authorizes the budget officer to make transfers within a function or department without changing the total appropriation to that function or department, determine if such transfers were made. If such transfers were made, verify that they were reported to the board and recorded in the minutes at the next regularly scheduled board meeting.
  - f. Trace such transfers from e., above, to the budget documents to verify that they were properly recorded.
9. Miscellaneous budget issues
- a. Test that a copy of the budget ordinance was available for public inspection from the date submitted to the board until adoption. [Consider inquiries of the budget officer.]
  - b. Verify that a copy of the budget ordinance was made available to newspapers and media in the area. Also, a statement should have been published informing the public that the budget had been submitted to the governing board and a copy is available for inspection. [Consider inquiries of the budget officer; examination of the check register for non-routine payments to the newspaper; examine copies of the newspaper containing the advertisement; confirm directly with the paper that such procedures were followed, etc.]
  - c. Verify that all expenditures in annually budgeted funds are included in the final budget. [Consider examining monthly budget to actual reports produced by the auditee. Review the minutes of the governing board meetings for indications that an amendment to the budget was made after expenditures exceeded appropriations.]
  - d. INTERIM BUDGETS Review a copy of the interim budget (if applicable) for the following items:

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- i. Verify that appropriations were only for the payment of salaries, debt service, and the usual and ordinary expenditures of the local government.
- ii. Verify that the appropriations for the above expenditures are at the same level as in the prior fiscal year.
- iii. Verify that the interim appropriations and expenditures were charged to the proper appropriations and expenditures in the final adopted budget ordinance.

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**B. PROJECT ORDINANCES AND CAPITAL PROJECTS** - This section *suggests audit procedures* to examine the methods and policies used to develop project ordinances adopted for capital projects.

**Obtain copies of any project ordinances for the following audit procedures. Once documented, maintain this as a permanent file and update annually.**

1. Verify that the project ordinance was adopted before the project was begun.
2. Verify that the project ordinance clearly identifies the project and authorizes its undertaking, subject to approval of the governing board.
3. Verify that the total of estimated revenues and estimated other funding sources are equal to the appropriations. Verify that the estimated revenues and other financing sources are reasonable.
4. Verify that upon adoption, the project ordinance has been recorded in the minutes of the governing board. Within five (5) days of adoption, copies of the adopted project ordinance should be filed with the finance officer, the budget officer, and the clerk to the governing board.
5. Verify, that if required by the governing board, certain information is included in the annual budget disclosing (i) projects expected to be authorized by project ordinance(s) during the budget year, and (ii) anticipated expenditures authorized by previously adopted project ordinances, expected to be disbursed during the budget year.
6. Verify that any revenues or other funding sources required to be accounted for in a capital project are properly recorded. This includes, for example, Community Development Block Grant (CDBG) moneys passed from the federal government through the North Carolina Department of Commerce.
7. Verify that bond proceeds were recorded in a capital project fund and that appropriation of bond proceeds were made only for:
  - a. Appropriations directly for the purposes stated in the bond order,
  - b. Payment of debt service on the bonds,
  - c. Payment to a capital reserve fund for eventual expenditure for the stated purposes of the bond. [Consider if the unit is subject to arbitrage on these funds in this case.]

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C. **CAPITAL RESERVE FUNDS** - These *suggested audit procedures* focus on the North Carolina requirements for establishing a capital reserve fund, in order to accumulate resources for a specific purpose.

**Obtain copies of establishing resolutions for capital reserve funds. Once documented, maintain this as a permanent file and update annually.**

1. Verify that the adopted resolution for a capital reserve fund includes the following information:
  - a. The purpose for which the reserve is created. [A unit of local government may establish a capital reserve fund for any purpose for which it may issue bonds. See G.S. 159-48 for a complete listing of allowable purposes.]
  - b. The approximate period of time that the moneys will be allowed to accumulate to fund the stated purpose.
  - c. The approximate amount to be accumulated in the fund.
  - d. The source(s) of the funds to be accumulated.
2. Verify that any amendments to the capital reserve fund are made by resolutions adopted by the governing board. Note that it is allowable to change the stated purpose for which funds are being accumulated. The new purpose must still be a purpose for which bonds could be issued.
3. Verify that any moneys or investments, the use of which is restricted to a particular purpose, are recorded in the capital reserve fund so that the restrictions upon the use of the resources is clearly maintained.
4. Verify that idle funds in the capital reserve fund(s) are invested in accordance with G.S. 159-30.
5. Verify that withdrawals from the capital reserve fund are:
  - a. Done only by a resolution of the governing board.
  - b. Only for the purpose stated in the establishing resolution, or the amending resolution.
  - c. Only for the amount of available funds. That is, a unit may not withdraw more than it has accumulated.
  - d. Made by transferring moneys from the capital reserve fund to a proper appropriation in one of the other funds maintained by the local government.
6. Verify that there were no expenditures made directly from capital reserve funds.

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**D. DUTIES OF THE FINANCE OFFICER** - These *suggested audit procedures* offer guidance for testing and evaluating the compliance of the finance officer with North Carolina General Statutes. Because of the finance officer's responsibility for the accounting system, suggested audit procedures for the accounting system are also included below.

**Through observation, inquiries of management, review of policies manuals, etc. evaluate the finance officer's compliance with the following items.**

1. Verify that the unit of local government has appointed a finance officer.
2. If the finance officer of a county or a municipality also acts as the tax collector, verify that this dual appointment has been approved by the Secretary of the Local Government Commission. [See G.S. 105-349(e) prohibiting the finance officer from being tax collector, except with specific approval. No member of the governing board should serve as tax collector. See G.S. 105, Article 26, and the North Carolina Department of State Treasurer Policies Manual for further information on the duties of a tax collector.]
3. Verify that the finance officer maintains accounts and records in accordance with generally accepted principles of governmental accounting.
4. Verify that the finance officer maintains an accounting system in compliance with G.S. 159-26 and with the rules and regulations of the Local Government Commission. See the following sub-items below.
  - a. Verify that the accounting system shows, in detail, the assets, liabilities, equities, revenues, and expenditures of the unit of local government.
  - b. Verify that the accounting system shows estimated revenue, other financing sources and uses, and appropriations. These budgetary items should be shown as adopted and subsequently amended.
  - c. **Fund Management**
    - i. A General Fund. – There is only one general fund
    - ii. Special Revenue Funds. One or more separate funds should be established for (a) functions or activities financed in whole or in part by property taxes voted by the people, (b) service districts established under the Municipal or the County Service Districts Acts, or (c) grant project ordinances.
    - iii. A Debt Service Fund.
    - iv. A Fund For Each Utility Or Enterprise Owned And Operated. Note that water or sewer funds may be accounted for in separate funds, or they may be combined. All other funds should be accounted for in separate enterprise

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funds. For example, the consolidation of water, sewer, electric, and garbage collection in one fund is not allowable.

v. Capital Project Funds. A separate capital project fund should generally be established for each separate bond order or debt instrument. If one capital project is financed by several bond orders or debt instruments, multiple debt instruments may be maintained in the one fund, provided the debt instruments are separately recorded **within** that fund.

vi. Trust And Agency Fund(s) The LGBFCA requires an agency fund whenever a county or municipality collects a supplemental tax for a school administrative unit; collects taxes for a special district; or collects a special assessment for a public authority.

vii. An account group recording the details of the general fixed assets of the unit or public authority.

viii. An account group recording the details of the long-term debt of the unit or public authority.

5. Verify that the finance officer is providing interim financial statements as often as requested by the governing board and/or the unit's manager.

6. Verify that the finance officer receives and disburses all funds of the local government in accordance with the LGBFCA. (See Section E of this audit program for Cash Receipts/Disbursements for more details.)

7. Verify that the finance officer maintains all records of bonded debt for the unit. [Test the budget ordinance that payments for both principle and interest are included in the ordinance. Verify that there have not been material overexpenditures of the budget for debt service.]

8. Verify that the finance officer supervises the investment of idle funds. (See Section F of this audit program for Investments.)

9. Verify that the finance officer has true accounting and faithful performance bond for an amount determined by the governing board. The amount may not be lower than **\$50,000**. [Consider verifying at this time the other bonding requirements. Verify that each employee that either has custody of \$100 or more of the unit's money or has access to the inventories of the unit, has a faithful performance bond in a sufficient amount. If individual bonds are not obtained, verify that the employees are covered by a blanket bond. The tax collector and the finance officer must have their own bonds. They may be included on the blanket bond if this provides coverage not included in their original bond.] Observe the records of deposits and receipts for evidence of material payments from the bonding company, suggesting claims made and settled.

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10. Verify that the finance officer has filed the Annual Financial Information Report (counties and municipalities only) with the LGC in a timely manner.
11. Verify that if other duties have been assigned to the finance officer, the finance officer has performed those duties. Special emphasis should be given to those duties having a financial impact upon the unit.

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E. **CASH RECEIPTS AND DISBURSEMENTS** - These *suggested audit procedures* incorporate specific North Carolina requirements such as the preaudit requirement prior to executing a contract or purchase agreement or prior to a disbursement. Because cash deposits and disbursements occur daily for most units, please consider these suggested procedures carefully. **Review the preaudit requirements of G.S. 159-28 carefully.** Failure to follow these statutes risks the expenditure of funds without budgetary authorization, and the finance officer risks personal liability for funds expended without budgetary authorization.

**Select samples of the appropriate documentation (checks, invoices, contracts, etc.) sufficient enough to provide evidence regarding the items and attributes below.**

1. Select a sample of executed contracts , purchase orders, or other documents obligating the unit to pay a sum of money:

a. Verify that the contract or purchase order has on its face a stamp or certificate similar to the following. *“This instrument has been preaudited in the manner required by the Local Government Budget and Fiscal Control Act”.*  
*{Signature of the Finance Officer}*

b. Verify that at the time of the contract or purchase order, there was (i) an appropriation authorizing the obligation in the budget ordinance, and (ii) there was a sufficient unencumbered balance in the appropriation for the obligation created by the contract.

2. Select a sample of validated deposit slips and bank statements. Verify the following:

a. Trace the deposit to the daily receipt records to ensure that all deposits made that day were in fact deposited.

b. Trace the deposit record to the monthly bank statement to verify that selected deposit tickets tie to the bank statement.

c. Observe the internal controls to verify that the finance officer receives all funds and makes all deposits for the local government. Verify that the finance officer supervises the deposits by duly authorized employees or officers if the finance officer is unable to deposit all funds personally. [At this point, consider evaluation of the segregation of duties in the auditee.]

d. Review the sample of deposits to verify that the appropriate fund is credited for the deposit. [Consider tax revenue deposits if the unit allocates tax revenue among several funds. Consider payments for water, sewer and garbage if the citizens may pay with one check, but the revenue is accounted for in different funds.]

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3. Select a sample of paid checks, invoices, and related documents for disbursements made by the unit:
  - a. Verify that a statement or certificate similar to the following appears on the face of the check. *“This disbursement has been approved as required by the Local Government Budget and Fiscal Control Act.” {Signature of the Finance Officer}*
  - b. Examine the sample checks for dual signatures. The signatures should be that of the finance officer or properly designated deputy finance officer, and an official of the local government or public authority, who has been designated for this purpose. If only one signature appears on the checks, look for evidence that the governing board has determined that the internal controls of the system adequately compensate for the lack of dual signatures and has formally waived the requirement for two signatures. [Consider if the management letter or the “Yellow Book” reports in previous years cited a lack of internal controls. Also consider the current state of the system. If internal controls do not appear adequate to support the elimination of a second signature, evaluate if a finding should be disclosed or a management letter comment should be made.]
  - c. Examine the related invoices. Look for evidence that the finance officer determined that the invoices were truly payables of the unit.
  - d. Examine the budget at the time of the disbursement. Determine if there was an appropriation in the budget ordinance, authorizing the disbursement made by the sample check. Also, determine if the amount paid had either been previously encumbered, or if there was a sufficient amount of unencumbered appropriation remaining to support the disbursement made by the sample check.
  - e. Review the check register for evidence of disbursements made by means other than checks or drafts on official depositories. [Large or frequent checks made to “Cash” or frequent replenishing of a petty cash fund may be evidence of disbursements being made by cash.]
4. To test the official depositories of the unit, consider the following procedures:
  - a. Verify that all depositories in use have been designated by board resolution as official depositories for the unit.
  - b. Confirm with the unit’s official depository(ies) that each of the unit’s accounts have been identified as public funds.
  - c. Review bank statements, to confirm that the unit’s deposits are in banks, savings and loan associations, or trust companies located in North Carolina. [\[Exception for certain CD’s if they meet the requirements of G.S. 159-30\(b\)\(1\)\]](#)
  - d. If the unit collateralizes deposits using the Dedicated Method, obtain written agreements and review quarterly confirmation reports verifying that (i) there was an agreement between the unit, and the board of directors of the depository, (ii) that there was an agreement between the unit, the depository, and the third party

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escrow agent, and (iii) the amount of collateral pledged is adequate to cover the unit's depository balance at all times throughout the year.

5. Verify that revenues and expenditures are accounted for using the modified accrual method.
6. If unit set up an irrevocable trust for other post employment benefits (OPEB) was it with the NC State Treasurer or did they have local legislation from the general assembly?

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F. **INVESTMENTS** - This section offers *suggested audit procedures* for examining the local government's (or public authority) compliance with North Carolina General Statute 159-30(c). The following procedures focus on the more complex investments allowed under this statute. For a thorough audit, consider obtaining a copy of G.S. 159-30. Note that the investments listed in 159-30(c) are the only allowable investments.

**Select samples of the appropriate documentation (monthly statements, transaction confirmations etc.) sufficient enough to provide evidence regarding the items and attributes below.**

1. Obtain an investment statement or verify with the unit's finance officer the unit's investment portfolio. Review the investment portfolio for compliance with G.S. 159-30(c). [Consider the need to review the investments throughout the year, not just the portfolio at the end of the fiscal year.]
2. If the unit has invested in banker's acceptance, verify that the accepting bank is incorporated in North Carolina.
3. Review the investment statement or confirm with the investment broker that if the unit is invested in a money market account, that it is not a money market mutual fund account. Look for such words as "shares" or "SHS" on the statement for indication of a mutual fund. The North Carolina Capital Management Trust Fund is currently the only allowable investment in a mutual fund for units of local government and public authorities in North Carolina.
4. If the unit has invested in commercial paper, verify that the commercial paper has the highest rating possible, A-1 rating by Standard and Poor's or a P-1 rating by Moody's. If the commercial paper is rated by both agencies, it must have the highest possible rating from both agencies to be an allowable investment.
5. If the unit has invested in repurchase agreements verify the following.
  - a. The underlying securities are direct obligations of the United States or obligations, the principal of and interest on which are guaranteed by the United States (only Treasuries and GNMA investments currently meet this criteria), and
  - b. The agreements are either with an FDIC insured bank or a "primary dealer" as recognized by the Federal Reserve Bank, and,
  - c. The underlying securities are delivered, either physically or in book entry, to the investing unit or authority, or to a third party depository verifying that the financial institution serving as trustee or fiscal agent for the unit is not the seller of the repurchase agreement, and,

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- d. The current market values of the underlying obligations are calculated at least daily, and the current market value does not fall below 100% of the repurchase price, and,
  - e. There is a valid and perfected security interest in the underlying obligations, granted to the unit of local government or public authority, and,
  - f. The securities are free and clear of any adverse third party claims.
6. ARBITRAGE FUNDS ONLY. If the unit of local government or public authority has funds invested which are subject to the arbitrage rebate requirements, and the funds are invested in mutual funds, verify the following.
- a. The mutual fund limits its own investments to tax exempt obligations, or,
  - b. The mutual fund invests in taxable obligations and the mutual fund provides arbitrage calculation services to the investing units and public authorities.
  - c. The investments of the mutual fund bear one of the two highest ratings of a nationally recognized rating service. If the investments are rated by more than one nationally recognized rating service, all ratings must be one of the two highest ratings available from the respective rating services.
7. Review custodial agreements for investments that are not physically held by the finance officer. Confirm that all securities not held by the finance officer are held in a bank's trust department.
8. Review the units LGC-203 reports, filed semi-annually. Verify that the reports were filed in a timely manner and that all information required to be disclosed was included on those reports.

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### Appendix A.

#### Fund Balance Available Calculation

The format below is based upon the statutory limitations on appropriation of fund balance available, as found in G.S. 159-8(a). Items below in italics are general comments to assist in the calculation. This should be applied to each fund that appropriates fund balance as an other financing source in the budget. Remember that the limitation is on fund balance available at the end of the **preceding fiscal year**.

	TOTAL
Cash and investments per audit report	<input type="text"/>
<i>Include cash, deposits, investments, and restricted cash.</i>	
Less	
Liabilities	<input type="text"/>
<i>Include all accounts payable, due to other funds, due to other governments, and similar items.</i>	
Portion of Deferred Revenue from Cash Receipts	<input type="text"/>
<i>Include prepaid taxes, grants received before being earned, and other amounts in deferred revenue that are included in cash balances rather than receivable balances.</i>	
Reserve for Encumbrances	<input type="text"/>
<i>If applicable, deduct the amount encumbered.</i>	
Fund Balance Available	<u>\$</u>

*Note, deduct the fund balance available from the total fund equity to determine the total reserves that should be accounted for, including reserved by State statute.*

**G.S. 159, Article 8 and Article 9, Part 2**

**Appendix B.**

Budgeting for Contingency

The format below is based upon the statutory limitation for contingency appropriations, as found in G.S. 159-13(b). The budgeted amount for contingency should not exceed 5% of all other appropriations.

**Contingency Limitation**

Amount of Appropriated Expenditures

	(A)
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Less:

Amount per Contingency line item, per budget ordinance

	(B)
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Appropriated Expenditures w/o contingency

\$                      (C)

Contingency appropriation as a percentage

Line (B) divided by Line (C) %