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Synopsis

- 1) The fundamental purpose of financial statements is to communicate useful financial information to the reader.
- 2) A government should prepare and publish a comprehensive annual financial report (CAFR) that encompasses all funds. The CAFR should contain the basic financial statements as well as combining statements by fund type and individual nonmajor fund statements. A letter of transmittal from management, management's discussion and analysis, additional statistical information, and certain financial schedules should also be included.
- 3) The financial report shall be prepared and published promptly after the close of the fiscal year.
- 4) The introductory section of the CAFR familiarizes the reader with the organizational structure of the government, the nature and scope of the services it provides, and a summary of the government's financial activities and factors influencing these activities. This section includes the transmittal letter from management.
- 5) The financial section of the CAFR should report the financial and operating results of the government's individual funds, demonstrate compliance with finance-related legal and contractual requirements, and assure adequate disclosure at the individual fund level.
- 6) The financial section of the CAFR may be composed of three levels: a) Basic Financial Statements, b) Combining and Individual Nonmajor Fund Statements, and c) Schedules. All three of the above may be required in some circumstances; however, adequate disclosure may require only one or two of the above. Also, Management's Discussion & Analysis (MD&A) is included as required supplementary information. The MD&A should be an objective, plain language overview of the unit's financial operations during the audit year.
- 7) In addition to the CAFR, governments may issue separate basic financial statements (the first level of the pyramid of the CAFR).
- 8) Neither generally accepted accounting principles (GAAP) nor finance-related legal and contractual requirements should be thought of as establishing maximum reporting requirements. Supplementary information may be equally valuable in meeting other information needs and in providing a better understanding of the finances of the governmental unit. The additional information may be included as appropriate.
- 9) North Carolina General Statutes (G.S.) 159-34 requires each governmental unit to have an annual independent audit and specifies the general terms and conditions of the audit.

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- 10) North Carolina Administrative Code (NCAC), Title 20, Chapter 3, Section .0500 [Administrative Rules, LGC](#)- Audit Contracts, includes several requirements concerning the scope of the annual audit and addresses the details of audit contracting and invoicing requirements.
- 11) The scope of an audit must be established clearly before work is begun. Considerations in setting the scope of an audit include the following: a) the funds to be audited, b) the audit period, c) any audit scope limitations, d) the opinions required, e) the report on internal controls, f) the tailored audit plan and program, g) the in-depth analysis of specific operations, h) the data processing review and i) any compliance, performance, and program audits.
- 12) Proper performance of audits of governmental units requires a thorough knowledge of the governmental unit's operations, effective audit planning, and development of and careful adherence to a complete audit program.
- 13) The output of an audit should include the audit opinion(s) on the fairness of the financial statements. If required or appropriate, the following should be included. A letter(s) presenting an evaluation of the internal controls, with recommendations for improving any weaknesses noted should be issued. Written reports of findings and recommendations from an in-depth review of specified federal or state programs.
- 14) The financial statements are those of the governmental unit and are the responsibility of its management even if the independent auditor does most of the actual statement preparation.
- 15) The auditor should be selected primarily on the basis of professional competence and experience. Appropriate criteria for selecting an auditor include: a) an understanding of the governmental unit's needs, b) the approach and methodology, c) qualifications in governmental auditing, d) the experience of the audit firm, and e) the cost of the audit.
- 16) An effective procedure for selecting an auditor is for a unit of government to prepare a request for proposal for audit services and send it to prospective auditing firms and evaluate responses based on the criteria listed in Point 15 above.
- 17) The governmental unit should have an audit committee made up of persons from the governing body with experience in financial matters.

Purpose

The fundamental purpose of financial statements is to communicate useful financial information to the reader. The primary readers of a local government's financial statements are the persons responsible for managing the local government, those associated with the purchase and sale of its securities, individuals at higher levels of government who have an oversight responsibility, and the public. The users responsible for managing the local government are concerned with the availability of money to conduct desired programs. They also are accountable for money designated for certain purposes or otherwise restricted by law, contract, grant, etc. Those associated with the purchase and sale of the unit's securities are concerned about the availability of monetary assets to be used for proposed and/or actual debt. Elected and appointed officials need reliable information to base their decisions on and to carry out their stewardship responsibility. The public is concerned about the overall financial status of the local government, the efficiency of its operations, and the types of services that were provided with their tax dollars. The financial statements required by Governmental Accounting Standards Board (GASB) pronouncements provide for these concerns. North Carolina General Statute (G.S.) 159-34 requires that a unit prepare financial statements in conformance with generally accepted accounting principles (GAAP) and that these financial statements be subject to an annual independent audit in accordance with generally accepted auditing standards.

Annual Financial Reporting Requirements

“Every governmental entity should prepare and publish, as a matter of public record, a comprehensive annual financial report (CAFR) that encompasses all funds of the primary government (including its blended component units). The CAFR should also encompass all discretely presented component units of the reporting entity.”¹ The financial section of the CAFR should contain (1) Management’s discussion and analysis (MD&A), (2) the basic financial statements, (3) required supplementary information other than MD&A, (4) any combining statements for nonmajor funds by type of the primary government (including both its blended and discretely presented component units), (5) individual fund statements and schedules for the funds of the primary government (including its blended component units). “The CAFR is the governmental entity's official annual report and should also contain introductory information, schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, and statistical data.”¹ While the publication of a CAFR includes additional details about a governmental unit, a CAFR is not a requirement in North Carolina. What is required in North Carolina is a set of basic financial statements and the notes to the statements. Any additional information, such as budget to actual statements and schedules, that demonstrates compliance with legal requirements must be included. The financial statements must be audited by an independent audit firm. Questions on these matters should be directed to the staff of the Fiscal Management Section of the NC Department of State Treasurer, commonly known as the staff to the Local Government Commission.

¹ GASB Codification of Governmental Accounting and Financial Reporting Standards (2001 Codification), Section 2200.101

GASB Statement 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, first effective for primary governments with fiscal year ends of June 30, 2002 modified the reporting model to put more emphasis on the larger, or major, funds of the unit. The reporting model also presents the financial information in a summarized form for the unit as a whole. This discussion is written assuming all units have implemented the new reporting model. The final phase of implementation will be those units with fiscal years beginning after June 15, 2003. For most local governments and public authorities, the conversion will be made for the fiscal year ended June 30, 2004.

The basic financial statements differ from the other statements in the CAFR in that they focus on government-wide and major fund data. The government-wide statements are presented such that they present a long-term view of the unit's financial condition. The fund statements are more focused on the financial condition of individual funds as it affects the next fiscal year. Nonmajor fund data is shown in total on the basic financial statements. Detailed individual fund information follows the notes to the financial statements. The other statements and schedules in the CAFR are reporting on finance-related legal and contractual provisions, rather than focusing on strict compliance with GAAP. The CAFR includes both (1) individual major fund data and aggregate nonmajor fund data by fund type, together with introductory, supplementary, and statistical information; and (2) schedules essential to demonstrate compliance with finance-related legal and contractual provisions. .

The CAFR should be prepared and published promptly after the close of the fiscal year. For most units of government, the audited financial statements must be submitted to the Secretary of the Local Government Commission by October 31. It should contain the report of the independent auditor, a letter(s) of transmittal, management's discussion and analysis, and such other information as management deems appropriate.

Reporting Entity

Determining the proper reporting entity is essential to accurate financial reporting and is applicable at all levels of local governments. This includes financial reporting by primary governments, governmental joint ventures, jointly governed organizations, and other stand-alone governments; and it applies to the separately issued financial statements of governmental component units. Component units include governmental enterprises, public benefit corporations and authorities, public employee retirement systems, governmental utilities, governmental hospitals and other healthcare providers, and governmental colleges and universities. Component units may be organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. For example, because local alcoholic beverage control (ABC) boards are required to disburse their profits to the city or county the board is located in, the ABC board is a component unit of the associated city or county. Properly defining the financial reporting entity is important because elected officials are accountable to their constituents for their actions. Because providing public services is, ultimately, the responsibility of elected officials, all governmental organizations are responsible

to elected officials at the federal, state, or local level. The reporting entity's financial statements should present the fund types of the primary government (including its blended component units) and provide an overview of the discretely (separately) presented component units. The financial statements should include information about the component units and their relationships with the primary government.

A. Primary Government

The foundation of a primary government is a separately elected governing body that is elected by the citizens in a general, popular election. As the core of the financial reporting entity, the primary government generally is the focal point for the users of the financial statements. A primary government is any state government or general purpose local government (municipality or county). A special-purpose government can also be a primary government (for example, a school district or a park district) if it meets all of the following criteria:

- (i) It has a separately elected governing body.
- (ii) It is legally separate.
- (iii) It is fiscally independent of other state and local governments.

A primary government consists of all the organizations that make up its legal entity. All funds, organizations, institutions, agencies, departments, and offices that are not legally separate are, for financial reporting purposes, part of a primary government. If an organization is part of a primary government, its financial data should be included with the financial data of the primary government.

B. Determining Separate Legal Standing

An organization has separate legal standing if it is created by an act of the General Assembly, or if it otherwise possesses the corporate powers that would distinguish it as being legally separate from the primary government. The corporate powers granted to a separate organization are listed in its corporate charter or in the legislation authorizing its creation. Corporate powers that usually indicate a separate legal standing would be the ability to have a distinct name, the ability to enter into contracts using that name, and the ability to sue or be sued in that name. If a unit has these characteristics and cannot turn to another governmental unit for relief, it is likely a separate legal entity.

C. Determining Fiscal Independence or Dependence

Some governmental units providing limited services may need to be reported with their primary government if they are financially dependent on the primary government. A special-purpose government is fiscally independent if it has the authority to do all three of the following:

- a. Determine its budget without another government's having the authority to approve and modify that budget.
- b. Levy taxes or set rates or charges without approval by another government.
- c. Issue bonded debt without approval by another government.

In determining whether a special-purpose government is fiscally independent, a distinction should be made between substantive approvals and ministerial (or compliance) approvals.

D. Financial Accountability

The primary government is financially accountable for a component unit if it appoints a voting majority of the organization's governing body and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government. A primary government has the ability to impose its will on an organization if it can significantly influence the programs, projects, activities, or level of services performed or provided by the organization.

Some component units should be blended as though they are part of the primary government. Even though it is desirable for users to be able to distinguish between the primary government and its component units, there are some situations where the component units are so intertwined with the primary government that they are, in substance, the same as the primary government. Depending on the circumstances, these component units should be reported as either special revenue funds, enterprise funds or departments of the primary government. An organization reported as a component unit should be included as a component unit of only one reporting entity.

For more information on this topic, refer to Section 99 of this manual, for further discussion of Reporting Entity and GASB 14 disclosure requirements.

Introductory Section of the CAFR

The introductory section is the first section of a CAFR. It familiarizes the reader with the organizational structure of the government, the nature and scope of the services it provides, and a summary of the government's financial activities and the factors that influence these activities. Some of the introductory section material is subjective in nature, in contrast to the relatively objective information reported in the financial and statistical sections. The introductory section also includes prospective information such as economic forecasts and discussions of future initiatives. Because of the nature of the introductory section material, detailed audit procedures are not normally applied to this section.

The recommended contents of the CAFR's introductory section include:

- (i) Letter of transmittal.
- (ii) A current Government Finance Officers' Association (GFOA) Certificate of Achievement for Excellence in Financial Reporting (if received in the past year).
- (iii) Listing of principal officials.
- (iv) Organizational chart.
- (v) Other material deemed appropriate by management.

The Financial Section, or "Pyramid," of the CAFR

The financial section of the CAFR may be viewed as a "reporting pyramid". The governmental unit need go only as far up the reporting pyramid as necessary to report the financial position and operating results of its individual funds, to demonstrate compliance with finance-related legal and contractual requirements, and to assure adequate disclosure at the individual fund entity level. Those statements and schedules necessary for these purposes are required; others are optional.

The levels of the pyramid are, from peak to base:

1. Basic Financial Statements (government-wide and the fund financial statements). The government-wide statements provide information on the primary government as a whole. The financial information is reported as if the government were operated as a business. The government-wide statements are presented in two columns or sections, one for governmental activities and one for business type activities, such as a county's landfill fund or a city's water and sewer fund. The fund financial statements provide information on the financial position of all funds and of the operating results of all funds. Major funds are presented individually, and nonmajor funds are presented in one summary total. They also serve as an introduction to the more detailed statements and schedules for the nonmajor funds that follow the notes to the financial statements. Separate columns should be used for each major fund and aggregate nonmajor fund information. The basic financial statements include the notes to the statements. The fund financial statements present information useful in evaluating a fund's ability to meet its goals and obligations in the coming year. The financial statements of all local governments and public authorities in North Carolina must meet this base level.

In addition to the CAFR, governmental units sometimes may issue the basic financial statements only. The basic financial statements are designed to be "liftable" for this purpose, that is, they can be "lifted" out of the CAFR and provide a fair presentation of the unit's financial condition. Such statements may be issued for inclusion in official statements for general obligation bond offerings and for widespread distribution to users requiring less detailed information about the governmental unit's finances than is contained in the CAFR. The basic financial statements are considered the minimum level for full disclosure in a stand-alone financial report.

2. Combining Statements for nonmajor funds. If a governmental unit has more than one nonmajor fund, combining statements for all nonmajor funds should be presented in a columnar format. The total columns of these combining statements should agree with the total summary amounts presented in the basic financial statements. Depending on a unit's circumstances, this may or may not be required. The budget to actual portion of these statements demonstrates a unit's compliance with the Local Government Budget and Fiscal Control Act (LGBFCA).

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3. Schedules. Data presented in schedules is not necessary for fair presentation in conformity with GAAP unless referenced in the notes to the financial statements. Schedules are used: (a) to demonstrate finance related legal and contractual compliance (e.g., where bond indentures require specific data to be presented, the analysis of tax levy, etc.); (b) to present other information considered useful (e.g., combined and combining schedules that encompass more than one fund, such as a Combined Schedule of Cash Receipts, Disbursements, and Balances - All Funds); and (c) to provide details of data summarized in the financial statements (e.g., schedules of revenues, expenditures, and transfers).

All three pyramid levels of detail may be required in some circumstances. On the other hand, adequate disclosure may require only one or two levels. Determination of the appropriate level of detail is a matter of professional judgment.

For additional information on preparing a CAFR, refer to the 2001 Governmental Accounting, Auditing, and Financial Reporting published by the GFOA (commonly known as the “Blue Book”). Also, the staff of the Institute of Government may be able to provide guidance to a unit issuing a CAFR.

Supplemental and Special Purpose Reporting

The accounting principles and illustrative procedures summarized in this policy manual and described in various authoritative pronouncements and interpretations are designed to enhance fiscal control, facilitate compliance with GAAP and finance-related legal and contractual requirements, and result in financial statements and reports that fulfill many user information needs. As such, they constitute the minimum standards of financial reporting for local governmental units.

The finance officer should assume responsibility for preparing supplemental fiscal data needed in reaching essential management decisions, formulating fiscal policy, informing the general and investing public, and submitting financial data to central compiling agencies, such as nationally recognized municipal securities information repositories (known as the NRMSIRs). The finance officer should not assume that the preparation of a CAFR, the issuance of separate basic financial statements, and demonstration of finance-related legal and contractual compliance prevents the additional reporting of fiscal data. Neither GAAP nor finance-related legal and contractual requirements should be construed as establishing maximum reporting requirements. Supplementary information may be equally valuable in meeting other information needs and in providing a better understanding of the finances of the governmental unit.

In the past, some units of local government have chosen to publish condensed financial information for use by the general public. Such information is often accompanied by illustrations. Commonly, pie charts are used to show the revenue sources and expenditures, as they relate to the unit’s budget as a whole. This is certainly permissible as a special report, but it does not replace the requirement that each unit have audited financial statements. At this time,

the continued popularity of these summary reports is doubtful. The new financial statement reporting format required by GASB 34 includes a section for Management's Discussion and Analysis (MD&A). The MD&A is intended to meet many of the needs that the condensed financial information now meets. Unlike the letter of transmittal in a CAFR, the MD&A is a required part of all governmental financial statements and is to be an objective explanation of the unit's performance in the past year. Additionally, with the increased use of the internet, summary financial information for many units is now much more available than in the past. The NC Department of State Treasurer maintains a web page with summary financial information for municipalities and counties, with six years of information presented at a glance. See the following link. [NC County and Municipal Financial Information](#)

Where additional data is needed, the finance officer should take the initiative to assure that the accounting system of the governmental unit is sufficiently flexible to facilitate supplemental and special purpose financial and statistical information on a timely basis.

External Audit Requirements, Contracts, and Invoices

North Carolina General Statute 159-34, "Annual Independent Audit; rules and regulations," requires that:

- (i) Each local governmental unit and public authority shall be audited as soon as possible after the end of its fiscal year.
- (ii) The audit shall be conducted by a Certified Public Accountant or by an accountant certified by the Local Government Commission (LGC) as qualified to audit local government accounts.
- (iii) When specified by the Secretary of the LGC, the audit shall evaluate the performance of a local government or public authority regarding compliance with all applicable federal and State agency regulations. This will be a single audit under the Federal and State Single Audit Acts. This is determined by the amount of federal and/or state financial aid spent during the fiscal year. See the [LGC Memos](#) for further details.
- (iv) The audit contract or agreement shall be in writing, shall include all its terms and conditions, and shall be approved by the LGC.
- (v) The terms and conditions of the audit contract shall include the scope of the audit and require that upon completion of the examination, the auditor shall prepare a report including the financial statements and the auditor's opinion and comments on the financial statements.
- (vi) The audit shall be performed in accordance with generally accepted auditing standards (GAAS). If a single audit is performed, the requirements for financial and compliance audits in the [Government Auditing Standards](#) issued by the Comptroller General of the United States also will apply. The financial statements must be prepared in conformity with GAAP.
- (vii) The finance officer shall submit to the Secretary of the LGC for his approval the number of copies of the audit report and bills for the audit required by the

Secretary. No audit bill may be paid by the unit without this approval. If a single audit is required, copies of the unit's audit report also should be distributed to federal agencies providing direct federal funding and to State agencies providing direct State or pass-through federal funding. (There will be some exceptions to this requirement that will be communicated to the units of government by the LGC.)

- (viii) Failure of a government official to produce books or information with intent to impede or mislead the auditor is a misdemeanor.

Required Audit Scope

NCAC 20:03.0500 - Audit Contracts, includes several requirements concerning the scope of the annual audit and addresses the details of audit contracting and invoicing requirements. The scope of the audit includes what the auditor is to examine and report on.

- (i) The scope of the audit should include all funds and ledgers of the governmental unit, and the audit should be conducted in accordance with GAAS and should include such tests of the accounting records and such other procedures (including direct confirmation of tax, utility, and other receivables) as are considered by the auditor to be necessary in the circumstances. At a minimum, the scope of the audit will be at the level of the combined financial statements. Exceptions to the scope of the audit may be made only by specific approval of the Secretary (of the LGC) or a deputy secretary and only for reasons that are fully explained.
- (ii) The audit should include a review of the internal control system of the governmental unit as provided by GAAS. The auditor should forward a management letter to the unit and a copy to the LGC, detailing his findings and his recommendations for improvement. If no management letter is issued, the auditor should provide the staff of the LGC with a brief written statement to that fact.
- (iii) The auditor should, after the completion of his examination, submit to the governing body a report of the audit with the number of copies required by the contract. The report should include all funds and ledgers included in the scope of the audit, and an expression of opinion on the financial statements included therein. If the expression of opinion is in any way qualified or if an opinion is disclaimed or not included for any reason, sufficient reasons therefore should be included in the report of audit. Copies of the audit report and any special reports issued as a result of the audit engagement shall be sent to the LGC.
- (iv) **The auditor should promptly notify the governing body and the LGC if circumstances disclosed by the audit call for a more detailed investigation by the auditor than necessary under ordinary conditions** (emphasis added).
- (v) No agreement(s) on the audit engagement that are not attached to and referenced in the audit contract should be enforceable by any party to said agreement(s).

Single Audit

The Federal Single Audit Act of 1984 requires State and local governmental units receiving certain amounts of federal financial assistance to obtain an independent "Single Audit" of all federal funds received under various federal programs. One single audit replaces the separate audits of individual grants to which the entities would have been subject to under prior federal requirements. The Federal Single Audit Act applies to all fiscal years beginning after December 31, 1984. A State single audit law, very similar to the federal single audit law, was passed by the 1987 Session of the General Assembly and was effective upon ratification. The combined effect of the two acts requires units of local government and public authorities (except public hospitals subject to A-133) which spend \$300,000 or more in federal funds or in a single State program to have a single audit. A single audit under the Acts consists of (a) a financial audit performed in accordance with the U.S. General Accounting Office's Government Auditing Standards (commonly called the "Yellow Book"), (b) a study and evaluation of the governmental unit's internal control structure relevant to federal and State assistance programs, and (c) tests of the governmental unit's compliance with laws and regulations relevant to federal and State financial assistance programs. Federal funds include those moneys that are received directly from the federal government and those federal funds that pass through other units of government. State funds include those funds appropriated by the State directly or indirectly to local units. These are not only payments of moneys, but also include loan guarantees, contributions other than cash ("in-kind" contributions), etc. Funds collected by the State and distributed as an agent for local governments would not necessarily be included in the compliance audit (i.e. sales tax, franchise tax, etc.). The single audit concept was developed to correct some of the problems with the "grant-by-grant" audits that were previously performed. In "grant-by-grant" audits, it was common for auditors from different grantor agencies to duplicate work by looking at the same records many times. The single audit primarily was designed to: 1) improve audit efficiency and reduce overall cost by having one financial and compliance audit that would be the basis on which all grantor agencies would rely, 2) concentrate audit efforts on programs that had the largest amount of expenditures, and 3) provide suggestions for improvements in future grant compliance through a study and evaluation of internal control and testing of the administration of grant programs.

North Carolina was the first state to require a single audit on State financial assistance programs. This was accomplished by piggybacking State requirements on the Federal Single Audit requirements to facilitate implementation of the single audit concept. At present, approximately one half of the units of government in North Carolina have single audits.

Audit Contract and Invoicing Requirements

NCAC 20:03.0500 - Audit Contracts, addresses the details of the audit contracting requirements, discussing such topics as:

- The audit contract format, scope, and contents;
- Approval of the contract;
- Definition of an audit engagement;

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- Who may perform audits;
- Approval of audit billings; and
- Reasons for the LGC to withhold approval of audit billings.

The Local Government Commission has specified certain requirements relating to the audit contract. An audit contract form, Form LGC-205 - Contract to Audit Accounts, is updated and published annually by the staff of the LGC. See the following link for an on-line version of the form. [Contract to Audit Accounts](#)

1. Item 7 of the audit contract approved by the Local Government Commission states that “all matters defined as ‘reportable conditions’ in AU 325 of the AICPA Professional Standards” must be submitted to the governing board in writing. Section AU 325 encourages, but does not require, reportable conditions to be communicated in writing; however, SAS 63 requires that all reportable conditions be reported in the auditor's report on the internal control structure. Any reportable conditions cited in the management letter also must be included in the auditor's report on the internal control structure. A copy of all written reports, including management letters, must be sent to the Secretary of the Local Government Commission. (If no management letter is issued, a statement to that effect should be sent with the audited financial statements.) Clearly, the intent of this is that the proper officials be informed about those practices and procedures of the unit which may need improvement.
2. By accepting an audit engagement that is subject to the standards for compliance audits as set forth in Government Auditing Standards, issued by the Comptroller General of the United States, the auditor warrants that he/she will meet all of these standards, as well as the standards for an external quality control review and continuing professional education. Item 5 of the contract requires the independent auditor to make available to the Secretary of the Local Government Commission, upon request, copies of all communications resulting from an external quality control review.
3. The mayor or chairperson of the governing board should type or print his/her name and title on the contract. The representative of the audit firm should print or type his/her name above his/her signature.
4. Auditors should use the contract forms with the most recent revision date. See top left corner of Contract to Audit Accounts for revision date. These contracts are usually updated in January of each year. If a unit and auditor wish to contract prior to January, the contract should be on the most recently updated version available.
5. Local governmental units and independent auditors are encouraged to contract for audit engagements as early as possible so the auditor may promptly begin performance of the audit engagement. Interim audit work is encouraged and in fact may be essential as part of the evaluation of the internal control structure required in a single audit. The contract requires audited financial statements for fiscal years ending June 30 to be submitted by October 31, within 4 months of the fiscal year end.. Final audited financial statements

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submitted after December 1 (for June 30 year-end audits) will require an amended contract before final invoice approval can be given. After December 1, final invoice approval will require three copies of an amended contract, a written explanation of the delay in submitting the audited financial statements, and a written description of the corrective actions that will be taken to ensure the timely completion of future audit engagements. This will be enforced. The amended contract should include a modified due date and should be signed by the original parties to the contract, unless the duties of the original parties have been assumed by other persons.

6. As a service to local governmental units preparing CAFRs, the staff of the LGC will continue to review camera ready drafts of audited financial statements and/or compliance sections of reports. To receive a thorough review, the draft statements should be sent to the LGC staff as soon as possible before October 31. The detail of review for reports received after October 31 may be limited. To speed the review process, the draft financial statements should be bound or in a notebook. Please do not send unbound drafts.
7. Compliance sections will not be reviewed by the staff of the LGC unless all required single audit reports are received, including a schedule of financial assistance, as well as a copy of the management letter. After October 31, an auditor who wants a report to be reviewed before it is released should send two bound copies of the final report and the management letter to the LGC office and hold all other copies of the report until the LGC's review is completed.
8. Local governmental units that are preparing and printing a comprehensive annual financial report (CAFR) will routinely need three to four weeks' printing time, which may prevent the auditor from submitting final copies of the CAFR to this office by October 31. In this situation, the staff of the LGC would request that a copy of the CAFR (including the required signed opinions, reports, and schedules related to a single audit) in its final camera-ready form be submitted to the staff of the LGC. This will enable the LGC staff to review the financial statements and compliance reports prior to the receipt of the CAFR. The LGC staff still will need to receive two copies of the printed CAFR as soon as they become available.

Regarding approval of interim and final invoices, the LGC staff provides the following guidance.

1. Communications between the local governmental unit and its independent auditor about the condition of the accounting records should be established prior to setting a fee for the audit engagement. A significant portion of the auditor's total charges could be determined by the condition of the local governmental unit's accounting records. Local governmental units and their auditors should gain an understanding of the definition and purpose of the audit as distinguished from bookkeeping services. The local governmental unit should discuss with the auditor what preparations and assistance can be made by its personnel before the auditor begins the audit. The work to be performed by each party should be clearly defined before the contract is signed.

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2. The fee for the audit engagement may be stated as a fixed dollar amount. It also may be expressed as a rate per hour or day, with or without a maximum limit being stated. Fees for non-auditing services, such as systems design and management consulting, should not be included in the fee for the audit; bills for these services should not be submitted to the Local Government Commission staff for approval. However, fees for bookkeeping services provided by the auditor that are necessary to perform the audit are deemed to be audit-related and should be included in the total fee for the engagement and provided for in the contract. The staff of the LGC requires that the audit fee be broken out into three categories – audit fees, year-end bookkeeping assistance, and preparation of financial statements.
3. Unforeseen circumstances requiring additional work and compensation are sometimes inevitable. The contract can and should be revised as soon as these conditions become known (Item 12 - Contract to Audit Accounts). Invoices in excess of a fixed fee contract cannot be approved without a properly executed contract amendment with the appropriate signatures of all involved parties.
4. Progress billings may be made if the local governmental unit and the auditor both concur. No interim or final bills for audit services should be paid by the local governmental unit prior to approval by the Secretary of the Local Government Commission. Before any invoices can be approved, there must be an approved contract on file with the Local Government Commission. Invoices should be submitted in triplicate. Upon approval by the Secretary, the original and one copy will be returned to the auditor. If approval cannot be made, the auditor will be notified as soon as possible. Regarding interim billings, the staff of the Local Government Commission may only approve up to 75% of a fixed fee contract. If a portion of the fee is variable, the entire fee is considered variable. On variable fee contracts, approval of interim billings is based on 75% of the fixed portion of the fee, (if there is a fixed portion), or 75% of the prior year's total fee, whichever is greater. No progress billings for June 30 year-end audits will be approved after December 1st without receipt of the audited financial statements, or a properly amended contract with a due date extended beyond December 1st. An explanation for the reason for the delay in the submission of the audited financial statements and the corrective actions to be taken to prevent late reports in the future also must be provided with the amended audit contract.
5. Final invoices for audit services normally should be sent to the Local Government Commission at the same time a unit's audited financial statements are submitted. Final invoices may be submitted separately from the audited financial statements; however, they cannot be approved until the LGC receives all required copies of the report and management letter, if applicable. *[Note: An exception involves the situation where a local governmental unit is printing its CAFR. In this case, final invoices can be approved when the final camera ready form of the CAFR (including the required signed opinions, reports, and schedules related to a single audit) is approved by the LGC staff. A cover letter should accompany the copy of the CAFR clarifying this situation. However, two*

copies of the printed CAFR should be submitted as soon as they are available. Auditors cannot submit two of the basic financial statements for invoice approval if the unit is preparing a CAFR.]

6. The auditor should submit two copies of the audited financial statements if the audit was performed under Government Auditing Standards (a Yellow Book audit). If the audit was not performed under Government Auditing Standards, only one copy of the financial statements must be submitted. Councils of Government should submit three copies of the audited financial statements. Submitting two copies of the financial statements fulfills the auditor's obligation to the staff of the LGC. The LGC staff will be responsible for sending the second copy to the State agency which most commonly distributes funds to that type of government. In many cases, the unit still has an obligation to supply other organizations with copies of the financial statements.
7. If a fixed fee for the audit is not stated, the invoice should show all calculations necessary to compute the fee from the rates shown in the contract. Report corrections and/or revisions requested by the staff of the Local Government Commission must be reviewed and accepted before final invoice approval is made. Auditors may submit copies of corrected pages, which will be inserted by the staff of the LGC into the original reports, superseding the relevant pages. The auditor should correct all other copies of the report, including any reports that have been sent to other federal or State agencies. Invoice approval cannot be made if the Secretary knows of any failure on the part of the auditor to perform the audit as provided in the contract. Any agreement relating to the audit engagement (i.e., engagement letter) that is not attached to and referenced in the Contract to Audit Accounts will not be enforceable.

Audit Scope

The scope of the audit indicates the extent of the audit procedures to be performed and any special audit requirements that must be met. Because audits can be undertaken for various purposes, the scope of an audit must be established clearly before any work is begun. Typically, a financial audit comprises an examination of the financial statements of all funds maintained by the governmental unit. Units which spend more than \$100,000 in combined federal and/or state financial assistance must have the books audited in accordance with Governmental Auditing Standards. Due to the Federal and State Single Audit Acts (discussed earlier), a unit of government that spends \$300,000 or more in federal funds or in a single State program must have a single audit on those funds. As a result of the audit, the auditor usually makes recommendations for eliminating weakness and improving the accounting and related systems.

Considerations in setting the scope of an audit include the following:

Funds to be Audited. The annual financial audit must cover all funds, agencies, and operations of a governmental unit including units determined to be component units for reporting purposes. See the earlier discussion on component units. The coverage should be indicated clearly in setting the scope. Compliance audits limited to certain funds,

agencies, or operations should be identified in the audit contract. A single audit on federal and State funds also will be included in the audit contract.

Audit Period. The annual financial audit covers the financial transactions of a single fiscal year. The single audit also covers a single fiscal year. The Single Audit Act greatly reduces the need for special grant audits, since one audit will meet the compliance audit requirements for grants. Grant audits will be needed only if grant funds were expended during periods that were not covered by single audits.

Audit Scope Limitations. The Local Government Commission should give prior consent to limitations on the scope of an audit that would preclude the auditor from expressing an unqualified opinion. If an auditor or a local government unit believes that there is a scope limitation, **they should contact the staff of the LGC immediately to discuss the problem.**

Opinion Required. Normally the regular annual financial audit results in an unqualified opinion. Depending on the circumstances, the auditor may be required to issue an opinion on the unit's overall compliance with laws and regulations and internal controls (per Government Auditing Standards). If the audit is done under the single audit standard, the auditor will issue an opinion on the compliance and internal controls of certain, specific programs. The opinions to be used in the compliance audit must be considered in defining the scope of the audit.

Report on Internal Controls. The audit agreement must define the auditor's responsibility to evaluate and report in writing his findings regarding the local government's system of maintaining accounting control over assets, liabilities, revenues, and expenditures. Reports on the auditor's evaluation of the system of internal control and any recommendations for improvements are usually included in a supplemental letter. If a single audit is performed, the auditor will be required to report on internal accounting and administrative controls of specific programs.

Tailored Audit Plan and Program. The governmental unit's management and/or audit committee may request that the auditor prepare a tailored audit plan and program and review this plan and program with them.

In-Depth Analysis of Specific Operations. If the governmental unit desires that the auditor conduct an in-depth analysis of specific administrative operations, this requirement should be stated in the audit contract. Examples of specific operations/functions that might be reviewed by an auditor include purchasing, cash management, data processing, and budgeting. If the auditor is engaged to perform such reviews, he should be required to report in writing his findings and his recommendations for improvement.

Data Processing Review. The scope of the audit should include a review of the data processing function. In addition, the auditor should incorporate testing the computer system in the audit, where appropriate.

Compliance, Performance, and Program Audits. If the audit scope should contain elements of compliance, performance, and program results, these requirements should be specified in the audit contract. This means the auditor would be expected to test the unit's compliance with certain laws and regulations. The auditor would also be expected to examine and report on the performance and program results against established criteria and goals.

Statements, Records, and Facilities to be provided by the Governmental Unit

For the auditor's examination, the local government should close out accounts and prepare preliminary statements and schedules for all funds. The accounting personnel should follow the same procedures to close out the final month as they followed to close out the preceding months. A closing entry should then be prepared that closes any excess (or deficit) of revenues over expenses to the Fund Balance account. If the accounting software does not do this automatically, this entry should then be posted in the post-closing column of the trial balance worksheet as follows: 1) post the excess (deficit) to Fund Balance, 2) "zero out" all revenue and expense accounts by entering the total of each account in the debit or credit column of the opposite sign. The closing journal entry should then be posted to the General Ledger. It is not necessary to zero out all revenue and expenditure accounts in the general ledger by recording an equal and opposite amount. Instead, accounting personnel can draw heavy red lines under the "Amount" column on the revenue and expense ledger sheets to indicate that the next year will begin with a zero balance. Accounting personnel should then prepare the financial statements from the trial balance worksheet totals. Reports should indicate on their face that they are preliminary reports, issued prior to audit, and are for internal use only. Accounting personnel should then prepare accounting records and supporting data for the independent auditors.

If the auditor needs to assist the local government in completing this preparation for the audit, the nature and amount of this assistance should be specified on the face of the audit contract as bookkeeping services. If the local government agrees to provide working space, materials, or personnel services to the auditor, this should be stated in the contract.

The government's staff should:

1. Gather documents needed by the auditors.
2. Prepare general schedules needed by the auditors, typically including:
 - a) A final trial balance of each fund.
 - b) A final trial balance of each subsidiary ledger.

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- c) A copy of the final budget presented to the board for the audit period, the original budget ordinance for the audit period, and all amendments to that budget ordinance.
 - d) A copy of all project ordinances and all amendments thereto for all projects beginning during the period or not fully completed prior to the end of the period.
 - e) A schedule of insurance in force during the year and of insurance expense for the year.
 - f) A schedule of investments of all funds at year-end showing both book value and estimated market value.
 - g) A schedule of all capital outlays during the period.
 - h) A schedule of all capital asset dispositions during the period.
 - i) A schedule of accounts payable at statement date.
 - j) Reconciliation of the final quarter's payroll tax returns.
 - k) Copies of all contracts with governmental grantor or grantee agencies.
 - l) Copies of all other contracts in force at statement date of a material amount.
 - m) Copies of all year-end bank reconciliations.
 - n) Copies of all invoices for legal services.
3. Prepare a schedule of federal and State financial assistance, if applicable. This schedule would list all of the federal and State funds spent as part of financial assistance and the related programs. See the Audit Manual on the State Treasurer's web site for an example of this. [\[Schedule of expenditures of financial assistance\]](#)

Moreover, governments can facilitate the audit greatly by carefully documenting throughout the fiscal year, the workings of certain internal controls that ordinarily may not provide an "audit trail". The better and clearer the supporting documentation, the easier the audit process. For example, a government should document:

- 1. The monitoring of federal grant subrecipients' compliance with applicable laws and regulations;

2. The monitoring of collateralization requirements for uninsured deposits and investments; and
3. The proper functioning of controls related to compliance with laws and regulations affecting federal and State financial assistance programs.

The Audit Planning Process

Conducting efficient and effective audits of governmental units requires a thorough knowledge of a governmental unit's operations, thorough audit planning, and development of and careful adherence to a complete audit program. The governmental unit should discuss the proposed approach to the audit with the auditor and should review the auditor's written audit plan to ensure that the auditor has:

- Planned the audit and documented this plan in writing;
- Evaluated alternative auditing approaches and selected an approach appropriate to the governmental unit, tailoring it as necessary;
- Developed an appropriate plan for evaluating internal control, and for communicating the results of this evaluation; and
- Included in the audit plan appropriate testing of transactions and procedures, using statistical sampling and computer auditing techniques where applicable.

Audit Output

The output of an audit should include the audit opinion(s), a letter(s) presenting an evaluation of internal control with recommendations for improving weaknesses noted, and written reports of findings and recommendations from in-depth reviews of specified administrative operations, if these reviews were required. Even though the auditor may draft the statements and footnotes, type and reproduce the statements on his/her stationery, and even bind the statements into a cover that carries the auditor's name, the financial statements are those of the governmental unit. That is, they are the responsibility of management of the governmental unit. Thus, the auditor is rendering an opinion on the fairness of the governmental unit's financial statements. Management has the ultimate responsibility for approving the statements and should not allow the financial report to be issued before carefully reviewing the statements for accuracy and adequate disclosure.

A. Types of Financial Audit Opinions

Depending on the outcome and/or the scope of the audit, the auditor should render one of the following types of opinions:

Unqualified Opinion. Usually, the auditor renders an unqualified opinion on the financial statements, stating that the financial statements present fairly the government's financial position and operating results in accordance with GAAP.

Auditors and/or the unit should contact the staff of the Local Government Commission before issuing a report with any one of the following opinions. If an unqualified report is possible with additional audit work, the LGC staff will require that work to be done. If an unqualified report is not possible, the audit contract must be amended before final invoices will be approved for payment.

Qualified Opinion. In a qualified opinion, the auditor states that the statements present fairly the financial position and results of operations except for certain specified departures from GAAP, or a material limitation on the scope of the audit. The reasons for qualifying the opinion should be stated clearly in the auditor's opinion letter. The most common reason for a qualified opinion is for the lack of a capital asset system.

Adverse Opinion. An adverse opinion is given when the auditor believes the statements do not present fairly the financial position, operating results, or changes in financial position of the governmental unit. The reason(s) for rendering an adverse opinion should be stated clearly.

Disclaimer. In a disclaimer of opinion, the auditor states that he/she does not express an opinion on the financial statements. A disclaimer is given when there is lack of sufficient competent evidential matter or when there are such restrictions on the scope of the examination that the auditor believes that it is not possible to express an opinion. This will happen if there is no accounting system or transactions were not recorded or were incorrectly recorded. This is a serious situation since it means that the governmental unit is not in compliance with G.S. 159-26 and has paid for an audit, but has not received the benefits of an audit. The reason for the disclaimer should be stated clearly.

Again, if anything other than an unqualified report is to be issued, the audit contract must be amended. The auditor and/or unit officials should contact the staff of the LGC before the report is issued.

B. Evaluation of Internal Control

During an audit, various internal accounting control weaknesses, processing inefficiencies, duplications, and other improvement opportunities are often identified. As an output of the audit, the auditor should prepare a written report(s) summarizing these findings and recommendations. These comments should be discussed in detail with management and with responsible department personnel to make sure that the observations are accurate and that the recommendations are understood and can be implemented. As a part of a single audit, one or more internal control reports must be

prepared to identify any material internal control weaknesses. Once these reports are presented to the governing board, they are public information and may not legally be denied to interested parties.

C. Reviews of Administrative Operations

A report(s) resulting from an administrative review, if one is conducted by the auditor, is another possible output of an audit. This report(s) should summarize findings and recommendations resulting from the review and should be discussed with management and with responsible department personnel. In a single audit, several compliance reports will be issued to report on the unit's compliance with grant requirements and compliance with legal and contractual provisions that could have a material effect on the financial statements. Modifications in the wording in these reports are used to show whether noncompliance existed and the severity of any noncompliance.

D. Schedule of Findings and Questioned Costs

As required by single audit standards, the auditor must report all violations and noncompliance related to the administration of federal and State financial assistance programs. All findings are reported on the Schedule of Findings and Questioned Costs and will usually include the following elements: the administrative law or regulation for which there was a violation (criteria); a statement of condition; the cause of the problem; the questioned cost, if any, (effect); the recommended action; the extent of noncompliance; the program title and identification number; and a response from management. It is to a unit of government's advantage to include a response since this will indicate to the grantor that management is aware of the problem and is taking steps to correct it. The Schedule also should include an update on the status of findings in prior years.

E. Other Reports

In some circumstances two other reports/schedules will be issued as a part of a single audit. A report on fraud, waste, and abuse is issued if there were any problems in this area. A schedule of noncompliance also may be issued if there are serious violations of material legal and contractual provisions.

Auditor Selection Criteria

The auditor should be selected only on the basis of professional competence and experience. The auditor should be a CPA, a CPA firm, or an accountant certified by the Local Government Commission as qualified to audit local governments. Local governments and public authorities should consider the following criteria for selecting an auditor:

Understanding of the Governmental Unit's Needs. While rendering an opinion on the fairness of the unit's financial statements is the primary purpose of the audit, many

auditors do make suggestions that would benefit the unit in general. To do this, the auditor should have an understanding of the local government's needs, the environment in which it operates, and its future plans. He/she should be able to identify existing problems and needs and respond to these needs using appropriate resources.

Approach and Methodology. The auditor's proposed approach and methodology should be comprehensive and tailored to the needs of the governmental unit and provide the proper level of audit. (See the earlier discussion about the scope of the audit.)

Qualifications in Governmental Auditing. The auditor's management and the staff to be assigned to the audit engagement should have had specialized governmental auditing training and should have experience in auditing governmental units.

Experience of the Audit Firm. The firm should have a demonstrated commitment to a state and local government audit practice. The firm should have the appropriate resources available to apply to the audit engagement and to provide other assistance as may be desired by the governmental unit.

Costs. The proposed fees should be reasonable in view of the type and quality of services the firm can and will provide. The National Intergovernmental Audit Forum, the U.S. General Accounting Office and the American Institute of Certified Public Accountants all recommend that an auditor not be selected solely on the basis of fee. Their position is that auditing is a professional service that should not be purchased strictly on the basis of the lowest cost. Studies by the General Accounting Office (GAO) have indicated that 90% of the single audits evaluated were deficient when the audit fee was the sole criterion used in auditor selection. The Local Government Commission feels that although the audit fee is important, it is not the most important criterion to be considered.

Auditor Selection Process

An effective procedure for selecting an auditor is for a local government to prepare a request for proposal (RFP) and send it to prospective auditing firms. The RFP should require a summary of the experience of the auditing firm and a description of how it would conduct and provide staffing for the audit. The content and scope of the RFP should be similar to that found in the sample Request for Proposal that has been included in this section as Appendix A. A government should typically request proposals for audit services every 3 to 5 years. (*Note: This does not mean that an auditor change is required every 3 to 5 years, only that a unit should evaluate potential auditors.*) An acceptable RFP also will address the following:

1. The scope of the audit. The RFP should designate the funds, and component units to be included in the audit. The RFP also should indicate clearly whether the audit scope is to be the basic financial statements, the combining nonmajor fund statements, and the schedules or only the basic financial statements. (*Note: the amount of federal and State financial aid spent and the grant agreements themselves may very well set the minimum requirements of what should be audited. A unit may choose to broaden the scope of the*

audit, but the unit may not contractually reduce the amount the amount of audit work below the minimum required by federal and State guidelines and professional judgment.)

2. The auditing standards to be used.
3. The type and extent of assistance to be provided to the auditor. The RFP should specify what types and amounts of services the government is ready to provide the auditor, both clerical and professional. If the government plans to offer the direct assistance of members of its internal audit staff, the nature and extent of this assistance should be clearly defined.
4. The reports that will be required, as well as related distribution and timing.
5. The need to retain working papers for an adequate period and the right to have working papers reviewed by appropriate third parties.

Audit Committee

The governmental unit should have an audit committee made up of two or three persons from the governing body with experience in financial matters. Persons from outside of the unit of government also could be included on the committee as external members. Potential candidates for such a committee are accountants, bankers, financial and insurance executives, and other persons with similar backgrounds. By providing governments with access to the views of a separate group of individuals knowledgeable in accounting and auditing matters, audit committees help prevent governments from placing excessive reliance on the auditor.

Appropriate tasks for a local governmental unit's audit committee include the following:

- Screen and select an independent auditor on the basis of specific criteria, including qualifications, experience, approach, and local needs;
- Serve as the liaison between the unit and the auditor and be the main contact for the auditor;
- Determine if the level of nonaudit services (e.g., management advisory services) to be provided by the auditor is appropriate;
- Review the audit plan and identify areas of audit concern and potential problems;
- Review the audit's progress;
- Review the final results, including the financial statements and the accountants' report. Review significant unresolved accounting and auditing problems. Review large adjustments or reclassified items, the adequacy of disclosures, and reasons for major fluctuations in balances. Review unusual or large commitments or contingent liabilities.

Review major differences in format or disclosure compared to other governments' reports;

- Examine carefully the control weakness discovered during the audit and reported in the audit findings and recommendations and in the auditor's "management letter;"
- Present to the entire governing body the financial statements, the report on internal control, and the compliance section of the audit report (if applicable); and
- Satisfy itself that management has taken appropriate action to correct any deficiencies discovered during the audit.

Engagement Letter

The local government and the auditor should have a clear understanding of the nature and terms of the engagement. This understanding is not required to be in writing, but often is as a matter of auditor policy. The auditor typically prepares the engagement letter after having reached an understanding with the local government.

The fact that there may be an RFP and/or standard contract does not reduce the need for the auditor to use a written engagement letter in addition to the RFP and/or contract. The local government and auditor should have a clear understanding about certain matters normally found in engagement letters, such as the need to receive written management representations, any agreed-upon client assistance, limitations on the responsibility for detection of fraud and defalcations, etc. These matters might not be included in the RFP and/or contract. In such a case, the local government and auditor should have the matters included in a separate engagement letter addressing the matters. The local government and the auditor also should determine that there are no contradictions or conflicts between the provisions in the contract and those contained in the auditor's engagement letter. The engagement letter is typically incorporated by reference into the terms and conditions of the standard audit contract.

Lawyers' Letters

SAS No. 12 requires a letter of inquiry from the auditor to the legal counsel as the primary means of corroborating information furnished by management concerning litigation, claims, and assessments. The letter is sent to inside counsel or outside lawyers who have the primary responsibility for, and knowledge of, particular litigation, claims, or assessments. By reviewing client legal files, by analyzing legal and professional fees and invoices, and by inquiry of governmental officials the auditor identifies lawyers who provided services on such matters.

The letter is from the local government and asks the lawyer to provide or corroborate directly with the auditor the following information concerning pending or threatened litigation:

- 1) The nature of the litigation.

- 2) The progress of the case to date.
- 3) How the governmental unit is responding or intends to respond to the litigation (for example, to contest the case or seek out of court settlement).
- 4) An evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.

With regard to unasserted claims, the lawyer is asked to comment on any possible unasserted claims specifically identified by management and to confirm that he will notify management of any unasserted claims that come to his attention that in his judgment must be disclosed in the basic financial statements under FASB Statement No. 5. The independent auditor will normally need to receive the attorney's letter before issuing the report on the audit.

Client Representation Letter

In brief, the client representation letter is a written statement from the local unit, written to the auditor. The letter states that certain representations and statements are true and accurate, *to the best knowledge of the local government official* (emphasis added).

Statement of Auditing Standards (SAS) No. 19 requires the auditor to obtain written representations from responsible client officials, and SAS No. 63 specifies certain representations that should be obtained in all audits of governmental units and in a single audit. The letter, among other things, confirms oral representations about specific matters given to the auditor during the audit.

The representation letter is obtained from local government officials who are responsible for and knowledgeable about, directly or through others in the organization, the matters covered by the representations. SAS No. 19 is clear that management's refusal to furnish written representations is a limitation on the scope of the audit engagement sufficient to result in a qualified financial opinion.

The client representation letter is usually signed by a local government official at the end of fieldwork. To avoid misunderstandings, the auditor should consider doing the following. Draft financial statements should be provided to the local official, with enough time for the officer to review the statements. The auditor should be available to discuss the statements and any concerns or questions the local official may have. The auditor should also explain what the client representation letter means and that it does not mean that the local official is being asked to express a professional opinion as the auditor is.

Sample Request for Proposal

The (governing board) of (name of governmental unit) (hereinafter called the “unit” invites qualified independent auditors (hereinafter called “auditor”) having sufficient governmental accounting and auditing experience in performing an audit in accordance with the specifications outlined in this Request for Proposal (RFP) to submit a proposal.

There is no expressed or implied obligation for the (name of governmental unit) to reimburse firms for any expenses incurred in preparing proposals in response to this request.

Type of Audit

The audit will encompass a financial and compliance examination of the unit’s Comprehensive Annual Financial Report (CAFR) [If the unit does not issue a CAFR, the above should be changed to Basic Financial Statements, supplementary information and compliance reports.] in accordance with the laws and/or regulations of the State of North Carolina, which include requirements for the minimum scope of the audit. The financial and compliance audit will cover federal, State, and local funding sources in accordance with generally accepted auditing standards; Government Auditing Standards; the Single Audit Act of 1984; the Single Audit Act Amendments of 1996; the provisions of OMB Circular A-133; Audits of State, Local Governments, and Non-Profit Organizations; the State Single Audit Implementation Act; and applicable laws and regulations.

Period

The unit intends to continue the relationship with the auditor for no less than three years on the basis of annual negotiation after the completion of the first year contract. Each year after negotiation has taken place an annual contract documenting the terms of the audit will be signed. Since one governing board may not obligate future governing boards, the remaining years of the agreement are subject to annual governing board approval.

July 1, 20X1 to June 30, 20X2
July 1, 20X2 to June 30, 20X3
July 1, 20X3 to June 30, 20X4

Requirements

The audit must be conducted in accordance with generally accepted auditing standards; Government Auditing Standards, issued by the Comptroller General of the United States; Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations; the State Single Audit Implementation Act, and any other applicable procedures for the audit of a government’s financial statements prepared in accordance with GAAP.

Appendix A (continued)

The audit must be completed and reports rendered four months following the fiscal year end (October 31).

A preliminary draft of the audit and required journal entries must be submitted to the Finance Director (or Audit Committee if applicable) by October 1 for proofing and reconciliation to the unit's records.

(Number) copies of each audit report, management letter, and other applicable reports must be supplied to the Finance Director (or Audit Committee if applicable) within the time frame cited above. In addition, the auditor is responsible for submitting the required two (three copies if unit is a Council of Government) to the Local Government Commission. Any other copies required will be charged on an as needed basis in addition to the quoted fee.

The financial audit opinion will cover the basic financial statements. Certain combining and individual financial statements and schedules, and related information are not necessary for fair presentation, but will be presented as additional analytical data. This supplemental information will be subjected to the tests and other auditing procedures applied in the audit of the basic financial statements, and an opinion will be given as to whether the supplemental information is fairly stated in all material respects in relation to the financial statements taken as a whole.

The working papers shall be retained and made available upon request for no less than three years from the date of the audit report.

In the event that circumstances arise during the audit that require work to be performed in excess of the original estimates, any additional costs will be negotiated prior to commencement of the work and an amended contract will be approved by the governing board and forwarded to the Local Government Commission for approval.

Audit Contract & Payment of Audit Fees

The audit contract must be approved by the Local Government Commission (LGC). Invoices are subject to approval by the LGC and the appropriate Grantor Agency, if applicable, prior to processing by the (type of unit). Interim or progress billings will be accepted up to 75% of the total fee prior to submission of the audited financial statements to the Local Government Commission and their approval of the audited financial statements.

Other Services

The auditor will prepare, type, and print the audited financial statements (or Comprehensive Annual Financial Report – if applicable). The auditor will submit a draft for review by the Finance Director (or audit committee if applicable). The Finance Director will return the draft with proposed revisions within 10 working days.

Appendix A (continued)

Any special condition that would require additional time and cost to the auditor should be mentioned here. Examples of special conditions are:

1. Fixed asset records which have not been audited previously;
2. Assistance to management's efforts to obtain the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting;
3. Assistance with the preparation of any schedules or budget compilation which may be required of the unit by SEC Ruling 15c2-12 which deals with secondary market disclosures;
4. Counties and municipalities only. Assistance with the preparation of the Annual Financial Information Report (AFIR) required to be filed with the Local Government Commission.

Description of Selection Process

(Number) copies of each section of the proposal should be submitted at the time and place indicated under the section entitled "Time Schedule for Awarding Contract."

Proposals will be submitted in two sections. The first section will be comprised of the audit firm's prior experience and qualifications of its personnel in performing governmental audits. The Audit Committee (or Finance Office staff) will evaluate the auditor/firm on educational and technical qualifications. The top five firms from the first section will have their second section opened and evaluated. The firm best meeting the experience, audit approach, and cost requirements will be selected.

The (type of unit) reserves the right to reject any or all bids, waive technicalities, and to be the sole judge of suitability of the services for its intended use and further specifically reserve the right to make the award in the best interest of the Town.

Failure to respond to any requirements outlined in the RFP, or failure to enclose copies of the required documents, may disqualify the bid.

First Section

The first section should address the requested information below. The corresponding responses should begin with the number of the requested information.

1. Indicate the number of people (by level) located within the local office that will handle the audit.
2. Provide a list of the local office's current and prior government audit clients, indicating the type(s) of services performed and the number of years served for each.

Appendix A (continued)

3. Indicate the experience of the local office in providing additional services to government clients by listing the name of each government, the type(s) of service performed, and the year(s) of engagement.
4. Describe your audit organization's participation in AICPA-sponsored or comparable quality control programs (peer review). Provide a copy of the firm's current peer review.
5. Describe the professional experience in government audits of each senior and higher level person assigned to the audit, including years on each job and his/her position while on each audit. Indicate the percentages of time each senior and higher level personnel will be on site.
6. Describe the relevant educational background of each person assigned to the audit, senior level and higher. This should include seminars and courses attended within the past three years, especially those courses in governmental accounting and auditing.
7. Describe the professional experience of assigned individuals in auditing relevant government organizations, programs, activities, or functions (e.g., utilities, solid waste, transit, airports, or health authorities and school systems).
8. Describe any specialized skills, training, or background in public finance of assigned individuals. This may include participation in State or national professional organizations, speaker or instructor roles in conferences or seminars, or authorship of articles and books.
9. Provide names, addresses, and telephone numbers of personnel of current and prior governmental audit clients who may be contracted for reference.
10. Describe how the firm meets professional independence standards.
11. Is the firm adequately insured to cover claims? Describe liability insurance coverage arrangements.
12. Describe any regulatory action taken by any oversight body against the proposing audit organization or local office.

Second Section

Proposals should include completed cost estimate sheets and any other necessary cost information in a separate sealed envelope marked – “Cost Estimate.” The (type of unit) plans to evaluate the qualifications of all firms submitting proposals before considering the Cost Estimate.

Appendix A (continued)

The second section should consist of completed cost estimate sheets, which will include the following information:

1. Type of audit program used (tailor-made, standard government, or standard commercial).
2. Use of statistical sampling.
3. Use of computer audit specialists.
4. Organization of the audit team and the approximate percentage of time spent on the audit by each member.
5. Information that will be contained in the management letter.
6. Assistance expected from the government's staff, if other than outlined in the RFP.
7. Tentative schedule for completing the audit within the specified deadlines of the RFP.
8. Use of internal audit staff (if applicable).
9. Specify costs using the format below for the audit year July 1, 20X1 to June 30, 20X2. For the two audit years, which follow, list the estimated costs. The cost for the audit year ending June 30, 20X2 is binding, while the two years which follow are estimated costs.
 - A. Manpower costs – Itemize the following for each category of personnel (partner, manager, senior, staff accountants, clerical, etc.) with the different rates per hour.
 1. Estimated hours – categorize estimated hours into the following: on-site interim work, year-end on-site work, and work performed in the auditor's office.
 2. Rate per hour.
 3. Total cost for each category of personnel and for all manpower costs.
 - B. Travel – itemize transportation and other travel costs separately.
 - C. Cost of supplies and materials – itemize.
 - D. Other costs – completely identify and itemize.
10. Other Information.

Time Schedule for Awarding the Contract

Request for proposal packages will be mailed by November 1, 20X1. Please acknowledge receipt of this request for proposal and your intent for proposal by November 14, 20X1.

Proposals signed by authorized officials will be received by (name of Finance Director), Finance Director at (location) until December 1, 20X1 at 2:00 p.m. Envelopes containing proposals should be clearly identified on the front as to the contents. The Finance Office will review the proposals and make a recommendation to the Board of Commissioners on December 15, 20X1 at which time the contract will be awarded.

A preproposal conference will be held on November 14, 20X1 at 2:00 p.m. to answer any questions that might arise and to discuss general background information on the unit and its operations. Information covered at the conference will not be sent to audit firms not attending the conference.

(Small units that will not hold a preproposal conference may wish to insert the following: Any questions should be directed to (name of person and title), at (phone number). Appointments may be scheduled to further discuss any specific matters necessary in preparing your proposal. Please call (name and title of person) at (phone number) to schedule an appointment.)

Description of the Governmental Entity and Its Accounting System

Entity

(Name) is a (type of unit) in North Carolina with a population of (number). The (type of unit) operates a solid waste system. (List all proprietary funds of the unit)

Based on the criteria set forth in GASB Statement 14, the following organizations will be included in the audit (for example):

- Carolina County Tourism and Development Authority (discrete component)
- Carolina Airport Authority (discrete component)
- Regional Library (joint venture)
- Soil and Water Conservation District (blended component)

(The above are examples of component units and joint ventures for a county. List all component units, joint ventures and related organizations for the unit.)

Funds

The (name of unit) maintains the following funds: (the following are examples, include all fund and account groups of the unit)

General Fund, including Debt Service Fund

Special Revenue Funds:

- Schools Reserve Fund
- Fire Districts Fund
- Revaluation Fund
- Emergency Telephone System Fund
- CDBG Fund

Capital Projects Funds:

- Schools Expansion Fund
- Human Services Building Fund
- Jail Construction Fund
- Annex Building Fund
- Airport Improvements Fund

Proprietary Funds:

- Enterprise Funds:
 - Solid Waste Fund
 - Solid Waste Construction Fund
- Internal Service Fund:
 - Hospitalization Fund

Trust and Agency Funds:

- Social Services Trust Accounts
- Fines and Forfeitures Fund
- Motor Vehicle Tax Fund

Permanent Fund

- Cemetery Care Fund

Private Purpose

- Scholarship Fund

Budgeted revenues, excluding project amounts, are estimated at (dollar amount) in FY 20X1/20X2. In addition, outstanding debt totaled (dollar amount) as of June 30, 20X1. The (type of unit) continues to maintain a (insert bond rating) bond rating from Standard & Poor's Corporation and (insert bond rating) from Moody's Investors Service and plans to hold a bond referendum in fall 20X1. We expect to issue Enterprise System Revenue Bonds in FY 20X2 to fund solid waste management projects.

Grants, Entitlements, and Shared Revenues

A copy of the Schedule of Federal and State Expenditures for the year ended June 30, 20X1 is enclosed with this RFP. Also included is a Summary of Auditor's Results showing the major programs for the prior year.

Appendix A (continued)

Budgets

The unit budgets all funds on the modified accrual basis of accounting as required by North Carolina law. Appropriations are made at the departmental level. *(If other, indicate level at which the budget is adopted.)* The unit also maintains an encumbrance system. Both the budgetary and encumbrance systems are integrated with the accounting system to provide easy comparison with actual expenditures.

Accounting Records

The (name of unit) maintains all its accounting records at the finance office located at (address). (If other organizations are to be audited under GASB Statement 14, the location of accounting records and financial staff should be provided.) The governmental unit maintains its cash receipts journal, cash disbursements journal, general ledger, and accounts receivable ledger on (type of computer system). The software is (name of software).

Assistance Available to Auditor

The unit will make available to the auditor sufficient help to pull and re-file records, and prepare and mail all necessary confirmations. A trial balance with budgeted amounts will be made available via computer diskette (or hard copy, e-mail, etc.) on Wednesday September 8, 20X1. The following accounting procedures will be completed and documents prepared by the unit's staff no later than September 8, 20X1 (Adjust dates if necessary. Smaller units may be able to provide this information at a much earlier date.):

- The books of account will be fully balanced.
- All subsidiary ledgers will be reconciled to control accounts.
- All bank account reconciliations for each month will be completed.

The unit's personnel will prepare the following items (**delete** any that the unit will not prepare; **add additional schedules** which would reasonably increase the efficiency and effectiveness of the audit):

General

1. Working Balance Sheet for each fund.
2. Working Statement of Revenues, Expenditures, and Transfers for each fund.
3. General Ledger transaction detail report for each account. (List any exceptions)
4. A copy of the original budget, all amendments, and the final budget as of June 30.

Appendix A (continued)

5. A copy of all project ordinances and all amendments for active projects during the audit period.
6. A copy of the operating and capital lease schedules itemizing contracts in force during the audit period as well as access to the lease files maintained in the (location) office.
7. A copy of board policies, including travel and investment policies.
8. Copies of all correspondence with the Local Government Commission, including semiannual Cash and Investment Reports (LGC-203), unit letters, faxes regarding the audited financial statements and compliance reports for the previous year.

Cash and Investments

1. All bank reconciliations for each month.
2. List of outstanding checks, showing check number, date, and amount.
3. Schedule of all investments for all funds at the audit date, showing book value and estimated market value at fiscal year end.

Receivables

1. Listing of unpaid tax bills in detail totaled by year as of fiscal year end.
2. Listing of outstanding (name of enterprise fund) receivables by account as of the fiscal year end.
3. Listing of outstanding (name of service) receivables in detail as of the fiscal year end.
4. Schedule of miscellaneous receivables booked as of the fiscal year end.

Other Assets

1. Schedule of insurance coverage.

Capital Assets

1. Print-out of all capital asset acquisitions during the audit year.
2. Print-out of all capital asset dispositions during the audit year.
3. Access to print-out containing calculations used in balancing the Capital Assets subsystem to the General Ledger.

Appendix A (continued)

4. Print-out of depreciation expense posted for the audit year.

Current Liabilities

1. Schedule of accounts payable including batch print-outs.

Long-Term Debt

1. Computation of vested vacation payable as of the audit date.
2. Debt Schedule for each debt issue and related payments.

Grants

The following will be compiled for each grant:

1. Grant agreement.
2. Budget.
3. All financial reports.
4. Correspondence with the grantor agency, including monitoring reports.
5. CFDA # and/or pass-through grant #.

Size and Complexity of Unit

Personnel/Payroll

Number of employees _____
Frequency of payroll _____
Number of payroll direct deposit advises _____

Property Tax (disclose if collected by another agency)

Number of tax bills issued (without motor vehicles) _____
Number of motor vehicle tax bills issued _____
Total dollar amount of most recent year's collections _____
Total dollar amount of levy _____

(Name of enterprise fund) Billing

Number of statements each month _____
Average number of delinquent accounts at month end _____

Purchasing

Number of purchase orders issued _____

Appendix A (continued)

Bank Accounts

Number of bank accounts _____
Number of escrow accounts _____
Average monthly activity in main accounts _____
Number of deposits (Central Depository) _____
Number of checks: _____
 Central Depository _____
 Payroll (direct deposit) _____

Management Information Systems:

Number of PCs on the premises _____
Core storage of the central processing unit _____
Total disk capacity of the system _____
Number of employed programmers capable of modifying
the operating system and the applications programs _____

The following financial applications are on the computer system:

General Ledger
Accounts Payable
Grants/Project Accounting
Payroll
Capital Assets
Taxes Receivable
(**Add** or **delete** any of the above depending on the unit's actual system)

The following financial application is on a separate computer system:

(List any applications on a separate PC system)

Special Conditions (list any special conditions, below are some possible items):

Does the unit collect taxes for others?
Does the unit perform fiscal or accounting functions for others?
Does the grantor agency or unit require any additional statements or schedules?

New Conditions (list any recent or upcoming changes):

Describe new debt authorizations or sales.
Describe new capital projects.

Suggested Reading

Audit Manual for Governmental Auditors in North Carolina,
North Carolina Department of State Treasurer, State and Local Government Finance
Division, 325 N. Salisbury Street, Raleigh, North Carolina 27603-1388. *Updated annually.*
Available through the links at www.treasurer.state.nc.us/SLG/frslg.htm

Audits of State and Local Governmental Units.
New York: American Institute of Certified Public Accountants, Inc., *Generally updated
each year.*

Codification of Governmental Accounting and Financial Reporting Standards (Statement 34
Edition) as of June 30, 2001.
Norwalk, CT: Governmental Accounting Standards Board, *Generally updated each year.*

Governmental Accounting, Auditing and Financial Reporting, Gauthier, Stephen J.,
Government Finance Officers Association, 2001, Chicago.