



State of North Carolina

Department of State Treasurer

RICHARD H. MOORE
TREASURER

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

JANICE BURKE
DEPUTY TREASURER

Memorandum No. 993

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To: Finance Officers of Counties, Health Districts, Mental
Health Districts and Certified Public Accountants

From: T. Vance Holloman, Director
Fiscal Management Section

Subject: Impact of 2003 Federal Compliance Supplements
Upon Local Government Audits

The United States Office of Management and Budget (OMB) recently released its revised Circular A-133 Compliance Supplements for audits of States, Local Governments, and Non-Profit Organizations. These federal Compliance Supplements are to be used by auditors of state and local governments for the fiscal year ending June 30, 2003. Among the changes to the 2003 federal Compliance Supplements are the generic requirements for testing eligibility, found in Part 3 of the Compliance Requirements. The supplement has been revised to state, "Therefore the auditor of the State is responsible for meeting the internal control and compliance audit objectives for eligibility. This may require the auditor of the State to perform or arrange for additional procedures to ensure compliant eligibility determinations when another entity performs part of the eligibility determination functions."

The Office of State Auditor (OSA) performs the Single Audit for the State of North Carolina. For several major programs of the State, a local government will make eligibility determinations. Under the new federal Compliance Supplements, OSA would have to test the eligibility determinations made by local governments or rely upon the testing of eligibility by local government auditors. Members of our staff arranged for a meeting of representatives of the OSA, North Carolina Association of County Commissioners (NCACC), North Carolina Association of Certified Public Accountants (NCACPA) and several county finance officers to discuss the best approach to fulfilling the new federal requirements.

Audits of local governments are subject to the State Single Audit Implementation Act. The intent of that Act is to limit the number of audits to which a local government will be subjected. The auditor's compliance audit for each local government should be used and relied upon by State agencies.

Local government auditors already test the eligibility determinations made by local governments for many programs. In reviewing the local government audits of major State programs from prior years, OSA found that they would receive adequate coverage of many major programs of the State with the selection process currently used by local government auditors. However, they found that some major programs of the State are not tested in enough local government audits to provide the OSA with

sufficient audit coverage to issue an opinion on compliance at the State level. Therefore, if the eligibility testing for these programs is to be performed by local auditors, OSA would have to select certain local governments to have certain programs tested as a major program in order to provide sufficient testing for the State's single audit. For these local government's, the local auditor may be able to substitute this program for another major program. If these programs were not treated as major programs by the predetermined local governments, the OSA might discover after reviewing local government audits that some programs had not been sufficiently tested in enough local governments to provide sufficient audit evidence. This would be discovered after local governments' audits were completed. This would subject local governments to additional audit procedures by either a local auditor or the OSA. The need for additional testing could lead to the State's Single audit being issued after its March 31st deadline and jeopardize federal funding of programs. OSA has stated that in order to obtain sufficient audit evidence, counties that receive a predominant amount of funding from the State for a program considered major by the State are likely to be chosen.

The only additional documentation that would be required if this work were performed by local government auditors would be a one page "turnaround document" that the local government auditor would complete. This would be submitted to this office along with the audit report. The turnaround document would be used by the OSA as part of their audit documentation to satisfy the federal eligibility compliance requirement. OSA has committed to keeping this document as short as possible.

Following a discussion of possible alternatives, all parties agreed that this new eligibility requirement should be best tested by the local government auditors. This would subject the local government to a single compliance audit. In order to meet the objectives of this compliance requirement, the OSA will identify major programs of the State that have eligibility determinations made by the local government. OSA will determine which local governments need to have the program included as a major program in their audits. OSA has committed to make this notification as early in April as possible each year. OSA will notify our staff, which will then notify local governments and their auditors as soon thereafter as possible. For the fiscal year ending June 30, 2003, this procedure will be necessary for two programs, and two others are possible. The two that have been identified go to counties only. One of the other possible programs may also go to public authorities. We will advise all units and auditors receiving this memorandum whether or not your unit is selected and which programs are selected for your unit.

Notification to local governments and auditors will be provided soon. The LGC shares the concerns of the OSA, NCACPA, NCACC and county finance officers about the short notice during this transition year. However, this was unavoidable due to the issue date of the federal Compliance Supplements and the requirement by the federal government that it be applied to the fiscal year ending June 30, 2003. We understand some auditors may have already begun their fieldwork. In addition, most local governments have already submitted audit contracts for that fiscal year. Units and auditors may amend their audit contracts if necessary. It is our understanding from OSA that if additional audit costs are incurred this may be considered a cost of the program.

Any questions relating to this memo can be directed to Jim Burke at (919) 807-2383, 807-2398 (fax), or james.burke@treasurer.state.nc.us.