

TITLE 20 – DEPARTMENT OF STATE TREASURER

Notice is hereby given in accordance with G.S. 150B-21.2 that the Local Government Commission intends to adopt the rule cited as 20 NCAC 03 .0508 and amend the rules cited as 20 NCAC 03 .0502 and .0505.

Link to agency website pursuant to G.S. 150B-19.1(c): <https://www.nctreasurer.com/office-state-treasurer/nc-administrative-code-rules>

Proposed Effective Date: November 1, 2020

Public Hearing:

Date: July 21, 2020

Time: 2:00-3:00pm

Location: Conference line: 1-877-402-9757; Access code: 4354283

Reason for Proposed Action: *Implementation of the proposed rule changes will promote conformity to auditing best practices and improve financial transparency by ensuring that auditors will present findings and fiscal issues identified in an annual audit report to units and the public and by ensuring that all units receive relevant information in a consistent manner through the auditor's presentation, regardless of the auditor employed. Additionally, the proposed rule changes will simplify the audit contract and audit fee business processes and streamline the responsibilities of the Local Government Commission staff in receiving and reviewing units' responses to audit findings and corrective action plans.*

The LGC is proposing to revise rules updating:

- *the requirements related to the submission and presentation of audit reports to local governments and public authorities, and*
- *the submission and approval of audit invoices.*

The LGC is proposing a new rule regarding:

- *the process for units that are required to provide responses and corrective action plans to the LGC as a result of audit findings and financial indicators of concern.*

Comments may be submitted to: Laura Rowe, 3200 Atlantic Ave, Raleigh, NC 27604; email dst.ncac@nctreasurer.com

Comment period ends: August 31, 2020

Procedure for Subjecting a Proposed Rule to Legislative Review: If an objection is not resolved prior to the adoption of the rule, a person may also submit written objections to the Rules Review Commission after the adoption of the Rule. If the Rules Review Commission receives written and signed objections after the adoption of the Rule in accordance with G.S. 150B-21.3(b2) from 10 or more persons clearly requesting review by the legislature and the Rules Review Commission approves the rule, the rule will become effective as provided in G.S. 150B-21.3(b1). The Commission will receive written objections until 5:00 p.m. on the day following the day the Commission approves the rule. The Commission will receive those objections by mail, delivery service, hand delivery, or facsimile transmission. If you have any further questions concerning the submission of objections to the Commission, please call a Commission staff attorney at 919-431-3000.

Fiscal impact. Does any rule or combination of rules in this notice create an economic impact? Check all that apply.

- State funds affected**
 Local funds affected
 Substantial economic impact (\geq \$1,000,000)
 Approved by OSBM
 No fiscal note required

CHAPTER 03 - LOCAL GOVERNMENT COMMISSION

SECTION .0500 - AUDIT CONTRACTS

20 NCAC 03 .0502 AUDIT CONTRACT

(a) The Secretary may promulgate a standard audit contract designed to include the specific requirements in Subdivision (c) of this Rule. The Secretary may revise the standard audit contract from time to time as circumstances require provided that the contract continues to include the requirements of this Section. The requirements may be included in the contract either specifically or by reference to this Section.

(b) Governmental units and their independent auditors may submit contracts on their own forms provided that the form includes all requirements, either specifically or by reference, in Subdivision (c) of this Rule.

(c) The following requirements and conditions shall be included in all contracts for governmental units:

- (1) The scope of the audit shall include all funds and ledgers of the governmental unit, and the requirement that the audit shall be conducted in accordance with generally accepted auditing standards and shall 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. Exceptions to the scope of the audit may be made only by specific approval of the Secretary or a deputy secretary and only for reasons that are fully explained as to the circumstances of the particular situation.

- (2) The audit shall include a review of the internal control system of the governmental unit as provided by generally accepted auditing standards. The auditor shall forward a management letter to the unit, detailing ~~his~~ the auditor's findings and ~~his~~ recommendations for improvement. The auditor shall forward a copy of the management letter to the Secretary, Commission.
- (3) Information based on the audited financial statements shall be submitted to the Secretary for the purpose of identifying Financial Performance Indicators and Financial Performance Indicators of Concern.
- ~~(3)~~(4) The auditor shall, after ~~the~~ completion of his or her examination, submit to the governing body a report of the audit with as many copies as requested in the contract. The report shall 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 modified ~~qualified~~ or if an opinion is disclaimed or not included for any reason, sufficient reasons therefor shall 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 transmitted forthwith to the Secretary, Commission.
- ~~(4)~~(5) The fee for the audit engagement shall be stated. All audit engagement fees and terms shall be clearly stated and shall allow for the computation of a final fee. The fee may be stated as a fixed dollar amount or as a rate per hour or day, either with or without a maximum.
- (6) The auditor shall present the audited financial statements including any compliance reports to the unit's governing body or audit committee in an official meeting in open session as soon as the audited financial statements are available but not later than 45 days after the submission of the audit report to the Secretary. The auditor's presentation to the unit's governing body or audit committee must include:
 - (A) the description of each finding, including all material weaknesses and significant deficiencies, and any other issues related to the internal controls or fiscal health of the unit as disclosed in the management letter, the Single Audit or Yellow Book reports, or any other communications regarding internal controls as required by current auditing standards set by the Accounting Standards Board or its successor;
 - (B) the status of the prior year audit findings;
 - (C) the values of Financial Performance Indicators based on information presented in the audited financial statements; and
 - (D) notification to the governing body that the governing body must develop a "Response to the Auditor's Findings, Recommendations, and Fiscal Matters," if required under Rule 20 NCAC 03 .0508.
- ~~(5)~~(7) The auditor shall promptly notify the governing body and the Secretary, Commission, if circumstances disclosed by during the audit call for a an expanded scope of work more detailed investigation by the auditor beyond that than necessary under ordinary conditions indicated by the auditor's audit planning and risk assessment.
- ~~(6)~~(8) No agreement(s) relating to the audit engagement but not attached to and referenced in the audit contract shall be enforceable by any party to said agreement(s).

(d) Form LGC-205 shall be provided for the convenience of those auditors and units who wish to use the form.

(e) The Commission is the state's agency charged with the duty of advising and assisting unit officials in all phases of fiscal management, and with promoting sound fiscal management, careful borrowing, and sound debt management practices as described in Rule 20 NCAC 03 .0101. To fulfill these duties, and pursuant to its authority under G.S. 159-34(b), the Commission may establish relevant criteria for gathering financial data to timely assist and identify units that are facing or may face fiscal management challenges or distress. For purposes of this Section, the following definitions apply:

- (1) Financial Performance Indicators are values derived from information included in the audited financial statements that assist the Secretary in improving the comparability of reporting a given unit's financial condition and financial performance. These criteria include, but are not limited to, adequacy of a unit's fund balance; liquidity or the ability to meet short-term obligations; solvency or the ability to meet long-term obligations; debt service coverage; leverage; and such other indicators of financial condition and financial performance as the Secretary may from time to time establish.
- (2) Financial Performance Indicators of Concern are Financial Performance Indicators with values which may indicate inadequate financial conditions or fiscal management concerns within the unit.

*History Note: Authority G.S. 159-3(f); 159-34;
Eff. February 1, 1976;
Readopted Eff. September 23, 1977;
Pursuant to G.S. 150B-21.3A, rule is necessary without substantive public interest Eff. January 9, 2018; 2018;
Amended Eff. November 1, 2020.*

20 NCAC 03 .0505 AUDIT BILLINGS

(a) All invoices for services rendered in an audit engagement as defined in Rule 20 NCAC 03 .0503 shall be submitted to the Commission for approval before any payment is made. Payment before approval is a violation of law.

(b) Invoices to be approved shall be submitted in duplicate to the Secretary, Secretary at the mailing address of the Commission.

(c) Invoices shall be approved only under the following circumstances:

- (1) There is a valid contract;
- (2) The report of audit has been received;

- (3) The audit billing ~~and the report of audit conform~~ conforms to the requirements of the contract and of this Section;
- (4) ~~Except in the case of a fixed fee, the~~ The audit billing shows all calculations necessary to compute the fee from the rates and terms shown in the contract; and
- (5) There are no circumstances known to the ~~secretary~~ Secretary indicating that the audit report may fail to conform to the requirements of the contract and of this Section. ~~a failure on the part of the auditor to perform the audit as provided in this Section.~~

Notwithstanding the above, the Commission may approve interim billings up to a maximum of ~~75 percent of a fixed or maximum fee, or, in the case where there is no fixed or maximum fee, up to a maximum of 75 percent of~~ the last year's billings for the last annual audit of the subject unit. unit submitted to the Secretary. Provided however, that the Secretary or a deputy secretary may approve a higher or lower ~~amount, on an interim billing amount~~ if he or she finds that such would be more equitable under a particular set of circumstances.

History Note: Authority G.S. 159-3(f); 159-34;
 Eff. February 1, 1976;
 Readopted Eff. September 23, 1977;
 Pursuant to G.S. 150B-21.3A, rule is necessary without substantive public interest Eff. January 9, ~~2018;~~ 2018;
 Amended Eff. November 1, 2020.

20 NCAC 03 .0508 RESPONSE TO THE INDEPENDENT AUDITOR'S FINDINGS, RECOMMENDATIONS, AND FISCAL MATTERS

(a) If the governing body of a unit of local government or public authority is notified by its independent auditor that the audited financial statements presented to the governing body included one or more significant deficiencies, material weaknesses, other findings or if the auditor determined that Financial Performance Indicators of Concern were identified based on information presented in the audited financial statements, then the governing body shall develop a "Response to the Auditor's Findings, Recommendations and Fiscal Matters" ("Response") signed by a majority of the members of the governing body and forward a copy of this response to the Secretary within 60 days of the auditor's presentation.

(b) The Response shall address each significant deficiency, material weaknesses and other finding(s) presented to the governing body and shall provide a financial plan to address each Financial Performance Indicator of Concern reported to the governing body and shall include the following:

(1) Audit Findings

(A) A written description of the procedure or process developed by the local government to address each finding, including all material weaknesses and significant deficiencies, and any other issues related to the internal controls or fiscal health of the unit as disclosed in the management letter, the Single Audit or Yellow Book reports, or any other communications regarding internal controls as required by current auditing standards set by the Accounting Standards Board or its successors.

(B) The description must provide sufficient detail that the governing body and the auditor can determine that the procedure or process will reasonably address the specific audit finding and is being properly implemented. The description may include such information as the date for implementation, the position titles responsible for implementation, the positions performing the procedures or processes, the frequency of performance, and other matters necessary to evaluate the success of the procedure or process.

(C) If the governing body disagrees with an audit finding, it shall fully describe its disagreement and explain the factors that support this determination.

(2) Financial Performance Indicators of Concern

(A) A written description of the plan developed by the governing body to address each Financial Performance Indicator of Concern.

(B) The plan must provide sufficient detail that the governing body and the auditor can determine that it will reasonably address the specific Financial Performance Indicator(s) of Concern. The description may include such information as the time period required for improvement, any governing body action required for implementation, the steps to increase revenue or reduce expenses, the frequency of performance evaluation, and other matters necessary to evaluate the success of the plan.

History Note: Authority G.S. 159-3(f); 159-34;
 Eff. November 1, 2020.