Oversight & Internal Controls
Kara Millonzi, Robert W. Bradshaw Distinguished Professor of Public Law and Government, UNC Chapel Hill School of Government

1

Accountability & Oversight

<table>
<thead>
<tr>
<th>Audits</th>
<th>Local Government</th>
<th>Internal Controls</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual/independent financial audit (G.S. 15-1)</td>
<td>Approves audit contracts</td>
<td>Governing board fiduciary duty</td>
<td>Statutory remedies</td>
</tr>
<tr>
<td>Yellow book audit (if expend over $100,000 combined state and federal $)</td>
<td>Reviews audits</td>
<td>Statutory roles and responsibilities</td>
<td>Whistleblowers</td>
</tr>
<tr>
<td>Single audit (if expend over $750,000 federal $)</td>
<td>Forensic audits</td>
<td>Internal processes and procedures</td>
<td>Citizen suits</td>
</tr>
</tbody>
</table>

There are separate, yet overlapping, mechanisms to oversee the proper stewardship of public funds. No one mechanism is sufficient.
Annual Audit Process

County may use any procurement process (or no process) to select auditor.*

Auditors should be completed by October 31 each year

Auditors required to make a presentation to the governing board in a public meeting within 45 days after audit report submitted to the LGC.

Audit presentation includes review of
• Material weaknesses
• Significant deficiencies
• Other findings of note
• Indicators of concern

Board of county commissioners must respond in writing to the findings within 60 days of the presentation. A majority of the board members must sign response and submit to the LGC.

Audit Categories

Audit category is based on total funds expended, not the receipt of funds.

Federal Single Audit: Expend $750,000 or more in federal dollars during the non-federal entity's fiscal year

Must follow federal procurement process to select auditor

Alternative Compliance Engagement (for ARP/CSLFRF ONLY):
• For local governments, including $0-$10 million in ARP/CSLFRF
• Only reason triggering Single Audit is ARP/CSLFRF, then can do this as alternative to Single Audit

Yellow Book Audit: Expend $100,000 or more in combined federal or state dollars

Financial Audit: All local governments must undergo an annual financial audit (G.S. 159-34)

Audit category is based on total funds expended, not the receipt of funds.

What is Compliance?

Policies, processes, and procedures to ensure that public funds are managed and spent appropriately and that assets are managed appropriately.

• Adopt the policies
• Incorporate procedures
• Assign responsibilities
• Follow the procedures
• Document everything
• Retain the documentation
If a county is notified by its independent auditor that the unit’s audited financial statements include one or more
• significant deficiencies,
• material weaknesses,
• other findings, or
• financial performance indicators of concern
the board of commissioners must develop a “Response to the Auditor’s Findings, Recommendations, and Fiscal Matters” signed by a majority of the commissioners and submitted to the LGC within 60 days of the auditor’s presentation.

Accountability & Oversight

<table>
<thead>
<tr>
<th>Audits</th>
<th>Local Government Commission</th>
<th>Internal Controls</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual independent financial audit (G.S. 159-6)</td>
<td>Approve audit contracts</td>
<td>Governing board fiduciary duty</td>
<td>Statutory remedies</td>
</tr>
<tr>
<td>Yellow book audit (if expend over $180,000 combined state and federal $’s)</td>
<td>Revenue audits</td>
<td>Statutory roles and responsibilities</td>
<td>Citizen suits</td>
</tr>
<tr>
<td>Single audit (if expend over $750,000 federal $’s)</td>
<td>Issuance regulations governing financial management</td>
<td>Internal processes and procedures</td>
<td>State Auditor</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Granting entities</td>
</tr>
</tbody>
</table>

There are separate, yet overlapping, mechanisms to oversee the proper stewardship of public funds. No one mechanism is sufficient.

Local Government Commission (LGC)

State oversight of local government finances
Financial management regulations
Debt approval
Resource
Evolving role
### Unit Assistance List

<table>
<thead>
<tr>
<th>The UAL identifies units with concerns related to units’ general fund, water/sewer quick ratio, income, and cash flow, and internal controls, or that have not yet submitted their audited financial statements (due four months following fiscal year end).</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>July 2022 UAL</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LGC may mandate</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Finance staff and manager training</td>
</tr>
<tr>
<td>• Modifications to internal controls</td>
</tr>
<tr>
<td>• Contract with outside finance professionals</td>
</tr>
</tbody>
</table>

| LGC approval required of more leases, vehicle financings, and other contracts. |

### LGC Takeover

<table>
<thead>
<tr>
<th>The LGC may impound the books and records of a county and assume full control of all its financial affairs:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• when the county defaults on any debt service payment or, in the opinion of the LGC will default on a future debt service payment if the financial policies and practices of the county are not improved, or</td>
</tr>
<tr>
<td>• when the county persists, after notice and warning from the LGC, in willfully or negligently failing or refusing to comply with the provisions of GS. Ch. 159.</td>
</tr>
</tbody>
</table>

The LGC also may impound the books and records and assume full control of county water and/or sewer system, if certain criteria are met.

| The LGC is vested with all the powers of the governing board as to the levy of taxes, expenditure of money, adoption of budgets, and all other financial powers conferred upon the governing board by law. |

### Local Government Commission Dissolves Troubled Town of East Laurinburg

*It is the First Time LGC Has Exercised Power Over Failing Local Government*

<table>
<thead>
<tr>
<th>Review, Rehabilitation, and/or Dissolution of Unsustainable Municipalities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establishes LGC-initiated and Municipal-initiated processes to do a thorough review of revenues and assets of a struggling municipality, formulate and implement an improvement plan (including partnering with county or other local governments), and, if it is not financially sustainable, a plan to dissolve the municipality.</td>
</tr>
</tbody>
</table>

Also allows for citizens to petition for referendum on dissolution.

Counties will likely take on more responsibilities for providing local government services.
### Accountability & Oversight

<table>
<thead>
<tr>
<th>Audits</th>
<th>Local Government Commission</th>
<th>State QMExternal</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual independent financial audit (G.S. 159-34)</td>
<td>Approves audit contracts</td>
<td>Governing board fiduciary duty</td>
<td>Statutory remedies</td>
</tr>
<tr>
<td>Yellow book audit (if expended over $100,000 combined state and federal $’s)</td>
<td>Issues regulations governing financial management</td>
<td>Statutory roles and responsibilities</td>
<td>Citizen suits</td>
</tr>
<tr>
<td>White audit (if expended over $750,000 federal $’s)</td>
<td>Provides assistance in financial management</td>
<td>Internal processes and procedures</td>
<td>State Auditor</td>
</tr>
</tbody>
</table>

There are separate, yet overlapping, mechanisms to oversee the proper stewardship of public funds. No one mechanism is sufficient.

---

#### Internal Controls

**Control Environment**
- Commitment to integrity & ethics
- Effective oversight by leadership
- Clear structure and procedures
- Commitment to competence
- Enforces accountability

**Risk Assessment**
- Specifies suitable objectives & analysis
- Identifies & analyzes risk
- Identifies & analyzes significant changes

**Control Activities**
- Develops control activities
- General controls over technology
- Thorough policies and procedures

**Information and Communication**
- Communicates expectations and control activities
- Identifies & analyzes significant changes

**Monitoring Activities**
- Conducts ongoing monitoring
- Identifies & analyzes significant changes

A county must have written internal controls that are sufficient to safeguard the assets of the unit.
Statutory Controls

Dated Statutes
Chain of Command Conflicts
Decentralized Government Structure
Digital-age Expectations
Necessary, but Not Sufficient

### Who Does What?

<table>
<thead>
<tr>
<th>Governing Board</th>
<th>Finance Officer</th>
<th>Budget Officer</th>
<th>Tax Collector</th>
<th>Purchasing Officer</th>
<th>Auditor</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Fiduciary Duty • Adopts/amends budget(s) • Sets tax/fee rates • Appoints finance personnel • Selects official depositories • Sets annual, pass, and Harbor Pensions • Selects collector banks • Selects auditor • Receives and responds to audit report</td>
<td>• Establishes and maintains accounting system • Controls expenditures and disbursements • Prepares and presents financial reports • Manages money and deposits of customers • Manages debt service, investments, and accounts receivable • Ensures that required financial reports are timely prepared and board must appear budget officer</td>
<td>• Prepares and submits annual budget and budget message to board • Enforces budget(s) • Ensures compliance of government • Manages the budget officer • Performs pre-audit procedures on report</td>
<td>• Prepares tax bills • Collects taxes • Accounts for tax collections • Prepares reports on tax collections</td>
<td>• Negotiates / enters into contracts • Performs bidding/RFP processes • Ensures pre-audit performed</td>
<td>• Perform quarterly independent audit</td>
</tr>
<tr>
<td>• Oversight / Fiduciary Duty • Adopts/amends budget(s) • Sets tax/fee rates • Appoints some finance personnel • Selects official depositories • Sets annual, pass, and Harbor Pensions • Selects collector banks • Selects auditor • Receives and responds to audit report</td>
<td>• Establishes and maintains accounting system • Controls expenditures and disbursements • Prepares and presents financial reports • Manages money and deposits of customers • Manages debt service, investments, and accounts receivable • Ensures that required financial reports are timely prepared and board must appear budget officer</td>
<td>• Prepares and submits annual budget and budget message to board • Enforces budget(s) • Ensures compliance of government • Manages the budget officer • Performs pre-audit procedures on report</td>
<td>• Prepares tax bills • Collects taxes • Accounts for tax collections • Prepares reports on tax collections</td>
<td>• Negotiates / enters into contracts • Performs bidding/RFP processes • Ensures pre-audit performed</td>
<td>• Perform quarterly independent audit</td>
</tr>
</tbody>
</table>

### Beyond the Statutes

The board of county commissioners must oversee the development and implementation of sufficient controls.

Credit / P-Card Policy
Travel Policy
Gif & Gift Policy
Purchasing & Contracting Policy
Property Management Policy

Segregation of Duties:
- Various duties are divided or segregated among different people to reduce the risk of error or inappropriate actions.

Physical Controls:
- When equipment, inventories, securities, cash and other assets are secured physically. This can occur by using locks, safes, passwords, or other environmental controls. Access is restricted to those with authority to handle them.

Reconciliations:
- Comparisons are made between similar records maintained by different people to verify transaction details are accurate. When reconciliations are properly maintained and reported on, they help to ensure the accuracy, completeness, and authorization of transactions. Reconciliations help to identify fraud or unauthorized transactions.

Information Processing Controls:
- Controls over data processing are essential to ensure the accuracy, completeness, and authorization of transactions. Data entered is subject to edit checks or matching to approved control files or totals. Numerical sequences of transactions are accounted for, and the totals are controlled and accounted for with proper balances and control accounts. Development of new systems and changes to existing ones must be documented and justified.
Constitutional Limitations on Local Government

Public Purpose
“The power of taxation shall be exercised . . . for public purposes only . . .”
N.C. Const. Art. V, Sect. 2(1)

You must have statutory authority to expend funds for any purpose.

Public funds must be spent for the general benefit of your county’s citizens.

Exclusive Privileges & Emoluments
“No person or set of persons is entitled to exclusive or separate emoluments or privileges from the community but in consideration of public services.”
N.C. Const. Art. I, Sect. 32

You may not provide direct benefit to private entities or individuals without receiving benefits in return.

Lawful?
City asks county to fund half of a major road project. Although the road project is within the city, it is a necessary part of an economic deal the county is working on to locate a large industrial manufacturing facility to the unincorporated part of the county, located just outside city limits.

Lawful?
A beloved city resident leaves his faucets running all day to accommodate his many cats. He has recently fallen behind on his rather high water bill. The department’s normal procedure is to shut off the water and impose a penalty for the delinquency. The county manager feels sorry for the resident and requests that the county’s governing board make an exception and waive his outstanding utility fees and late penalties. To a cheering crowd, the board votes unanimously to do so.
Lawful?
At budget time, a local nonprofit asks the county for a $1,000 donation.

Support vs. Partnership

A local government generally DOES NOT have statutory authority to support a nonprofit’s, community organization’s, or other private entity’s general operating or capital expenditures (but there are a few exceptions).

A local government may enter a partnership (contractual agreement) with any private entity to fund an activity, service, project, etc. that the local government has statutory authority to engage in.

Partnership

Identify project, service, or other activity that local government could undertake itself.

Contract with private entity to undertake it on behalf of the local government.

§ 153A-449. Contracts with private entities
(a) Authority—A county may contract with and appropriate money to any person, association, or corporation, in order to carry out any public purpose that the county is authorized by law to engage in.

A budget appropriation is never sufficient to provide funding to a private entity. A local government needs to have a contractual agreement that specifies the project, service, or activity the private entity will carry out in exchange for payment by the local government.
A local government generally **DOES NOT** have statutory authority to support a nonprofit's, community organization's, or other private entity's general operating or capital expenditures (but there are a few exceptions).

Even if exception applies, county still must have contract with private entity.

**EXCEPTIONS**

A county may contract with the following entities to support their general operating and/or capital expenditures:

- Volunteer fire departments and rescue squads
- Nonprofit museums or arts organizations
- Animal shelters
- Private hospitals
- Certain private entities serving developmentally disabled
- Certain historical organizations