

# ARPA

## Auditing, Internal Controls, and Monitoring

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# Internal Controls – 2CFR 200.303

*Organizations must develop and implement effective internal controls to ensure funding decisions under the SLFRF award constitute eligible uses of funds and document determinations.*

*Each entity can develop its own system of controls but must be in compliance with both the GAO Green Book and COSO integrated framework of internal control.*

# What is COSO?

- Council of Sponsoring Organizations of the Treadway Commission
  - American Accounting Association
  - American Institute of Certified Public Accountants
  - Financial Executives International
  - Institute of Internal Auditors
  - Institute of Management Accountants (formerly known as the National Association of Accountants)

# Internal Controls - COSO

- COSO I and COSO II
  - COSO I: *Internal Control-Integrated Framework* (issued in 1992)
  - COSO II: *Enterprise Risk Management-Integrated Framework* (issued in 2004)

COSO I

# Framework Objectives

Effectiveness and efficiency  
of operations

Reliability of financial  
reporting

Compliance with applicable  
laws and regulations

# COSO II Framework Objectives

## Strategic objectives

- Higher level objectives
- Aligned with and supporting the organization's mission
- Unique to COSO II

## Operations

- Effective use of its resources
- Efficient use of its resources

# COSO II Framework Objectives (cont.)

## Reporting

- Reliability of reporting
- Includes both financial *and* nonfinancial information
- Is both internal *and* external
- Differentiation of internal reporting (unique to COSO II)

## Compliance

- Applicable laws and regulations

# COSO I Framework Components

- Control environment
- Risk assessment
- Policies and procedures
- Communication
- Monitoring





## COSO II Framework Components

### Internal environment

- Risk “appetite” and philosophy
- Integrity and ethical values

### Objective setting

- Must be consistent with risk “appetite”

### Event identification

- Includes internal and external events
- Distinguishes risk and opportunities

# COSO II Framework Components (cont.)

## Risk assessment

- Risk analyzed to determine management strategy

## Risk response

- Avoid, reduce, share, accept
- Develop actions to align risks with management's risk "appetite"

# COSO II Framework Components (cont.)


## Control activities

- Policies and procedures established
- Policies and procedures implemented
- Risk responses effectively “carried out”

## Information and communication

- Relevant information identified, captured and communicated
- Across all levels

- Monitoring
  - Entirety of enterprise risk management monitored and modified as necessary
  - Accomplished through....
    - Ongoing management activities
    - Separate evaluations
    - Combination of both



## COSO II Framework Components (cont.)

# What about SOX and OMB A-123?

## SOX

- Mgmt responsibility
- Control environment
- Risk assessment
- Info & Training
- Documentation
- Assessment of Effectiveness & Reporting

## OMB Circular A-123

- Mgmt responsibility
- Control environment
- Risk assessment
- Info & communication
- Control Activities
- Documentation
- Assessment, Correction & Reporting



# What is the Green Book?

*Important facts and concepts related to  
the Green Book and internal control*

RELATED TO GAO-14-704G

# What is internal control?

Internal control is a process that helps an entity achieve its objectives. It is the first line of defense in safeguarding public resources.



**Objective  
identified**



**Controls  
designed**



**Controls  
in place**



**Objective  
achieved**

*Standards for Internal Control in the Federal Government*, known as the Green Book, is the document that sets internal control standards for federal entities.

# How does internal control work?

Internal control helps an entity



**Run its  
operations  
efficiently and  
effectively**



**Report reliable  
information  
about its  
operations**



**Comply with  
applicable  
laws and  
regulations**



# Who would use the Green Book?

Here are some examples of people who use it



Someone who manages programs for federal, state, or local government

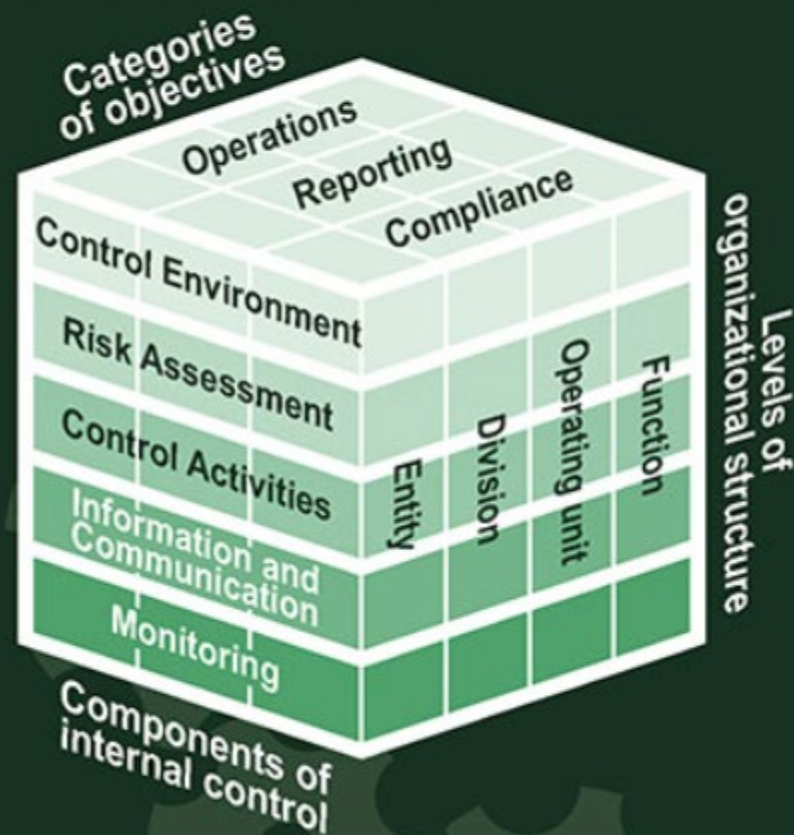


Someone conducting a performance audit or a financial audit



Someone responsible for making sure that personnel follow policies and procedures related to any and all job responsibilities

# How is internal control organized?



*Standards for Internal Control in the Federal Government (the Green Book)* is organized by the five components of internal control, and apply to staff at all organizational levels and to an entity's operations, reporting, and compliance objectives.

# What makes up the five components?



## Principles

Each of the five components contains several principles. Principles are the requirements of each component.

## Attributes

Each principle has important characteristics, called attributes, which explain principles in greater detail.

LOOKING FOR MORE INFORMATION?

Visit [GAO.GAO/GREENBOOK](http://GAO.GAO/GREENBOOK). Read the full report: GAO-14-704G.





## GFOA Best Practices on Internal Controls

- Internal Control Deficiencies in Audits
- Internal Control Environment
- Internal Control Framework
- Internal Control for Grants
- Internal Control and Management Involvement
- Whistleblowing

<https://www.gfoa.org/best-practices/accounting-and-financial-reporting>



GFOA Best  
Practices Link

- Administrative costs potentially paid by ARPA funds
  - Increased audit costs
  - Increased monitoring costs
  - Increased reporting costs
  - Potential contractor (administrative) costs

## Potential Relevant ARPA Costs

# Potential GAAP Reporting Impacts

## Major fund determination

- Regardless of the “point of entry” fund
- Would lead to increased audit costs

## Subject to Yellow Book and possibly Single Audit requirements

- Impacts would potentially last through 2026 at a minimum

# New Audit Submission and Review Process

- Starting with June 30, 2021, audits, new process for local entities and their auditors to submit audits and communicate results
- No more unit letters!
- Strongly encourage you to review process thoroughly on our webpage:

<https://www.nctreasurer.com/links/state-and-local-government-finance/lgc/local-fiscal-management/annual-audit/submitting-your-2>



# Communicating Audit Results and Concerns

- Units will get immediate feedback on financial data when submit Data Input Workbook
  - Financial benchmarks
  - Benchmarks that indicate financial concerns
  - Performance Indicators Print tab on the Workbook
- Auditor must present audit in a public meeting within 45 days of audit being submitted to LGC
  - Auditors' presentation must cover all significant deficiencies, material weaknesses, and other findings noted in the audit
  - Must cover status of prior year findings
  - Must cover financial indicators of concern
  - Must notify board of need to respond to findings and financial indicators of concern

# Communicating Audit Results and Concerns

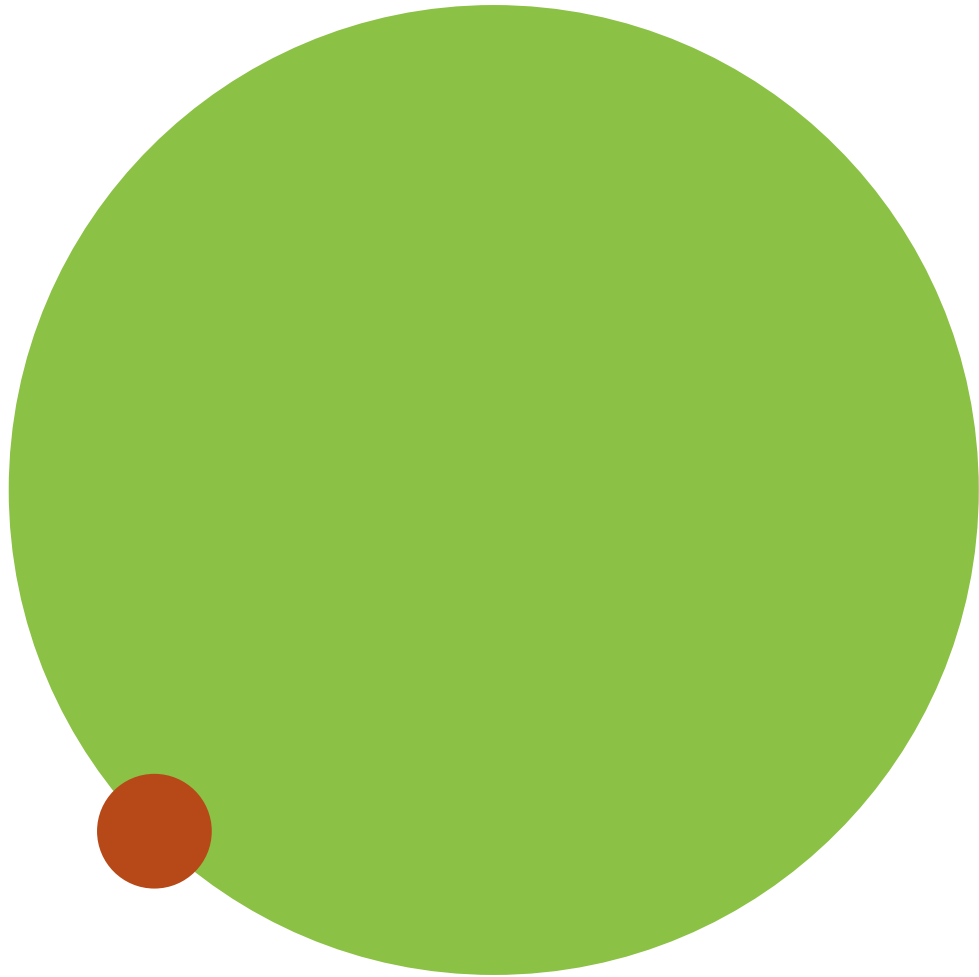
If auditors notify board of any findings or financial indicators of concern, board must send a detailed corrective action plan to LGC staff within 60 days of auditors' presentation

Summary of pertinent findings and financial indicators of concern, along with corrective action plan, will be submitted to the LGC with any debt application presented

# Communicating Audit Results and Concerns

- Corrective Action Plan
  - On time
  - Thorough; be sure to address each finding and/or FIC
  - Describe action taken whenever possible; describe results of action; quantify if possible
  - Planned action as applicable

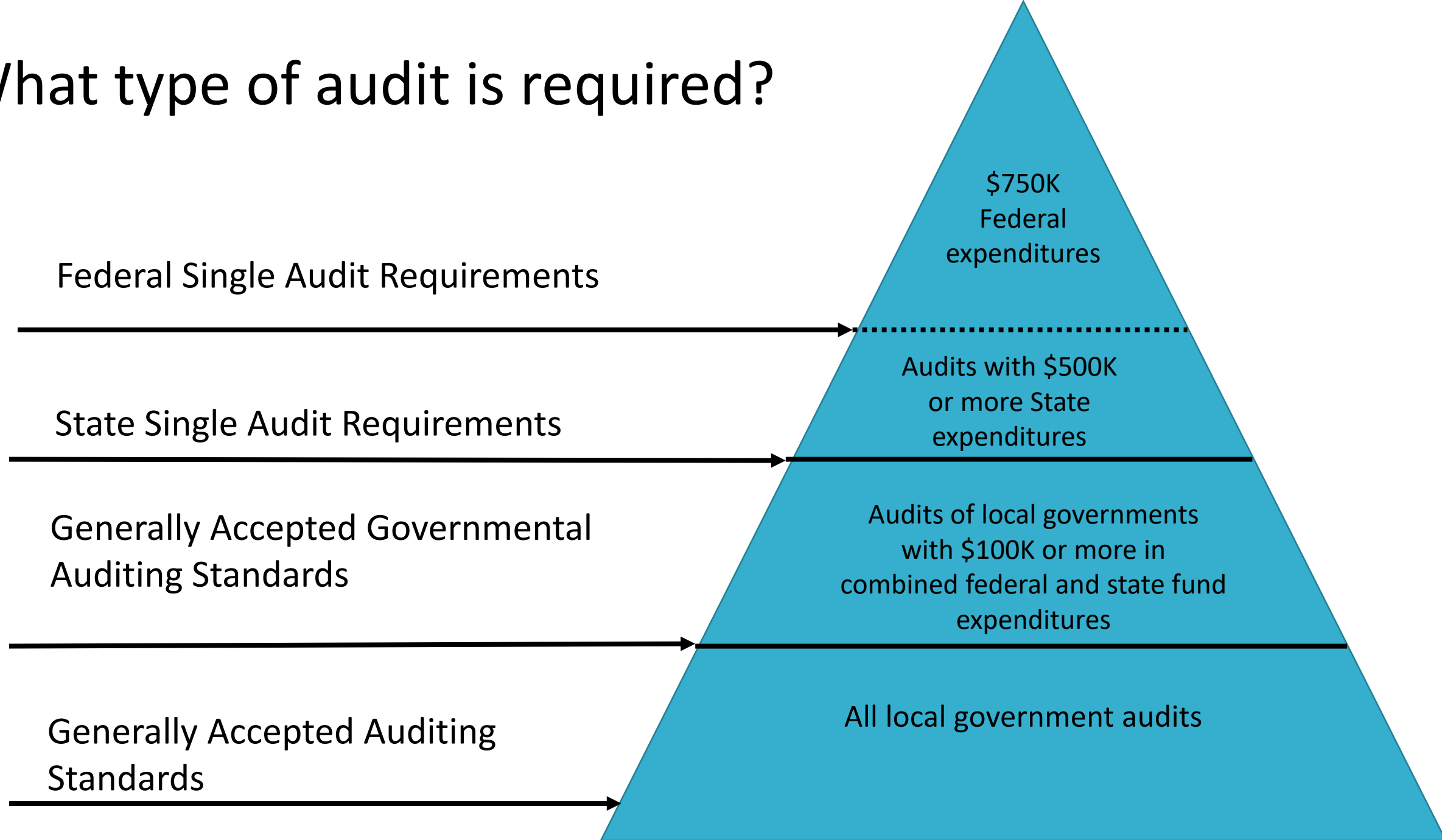




# Compliance Auditing for ARPA Funds



# What type of audit is required?



# Yellow Book Audits

- What is a Yellow Book audit and why do I have to have one?
  - Proper title is “Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards”
  - Required when an entity **expends** \$100,000 or more in combined State and/or Federal funds in a fiscal year
- What does this have to do with ARPA funds?
  - With the receipt and expenditure of ARPA funds, many units will cross the threshold above which a Yellow Book audit is required, some of you for the first time
- Significant impact on what auditor can and cannot do with regards to non-audit services, such as drafting your financial statements

# Yellow Book Audits

**Preparation of draft financial statements in their entirety**, from a unit's trail balance or underlying accounting records, **creates significant threats to auditors' independence** that **will** require the application of safeguards to reduce the threats to an acceptable level (United States Government Accountability Office, Government Auditing Standards - 2018 Revision, p. 51) (emphasis added)

# Yellow Book Audits

- In addition, if the auditor cannot identify someone at the client – either an employee or hired contractor – with the sufficient ***Skills, Knowledge and Experience – SKE*** – to claim responsibility for the financials, the auditor CANNOT write the financial statements
- Two-pronged test – first is identifying the appropriate SKE person and second is that drafting the statements creates a significant threat to independence. If can't get past the first one, second test doesn't matter



# Yellow Book Audits

The auditor should determine that management of the unit of government has designated an individual who possesses suitable skill, knowledge, or experience (SKE) to sufficiently oversee the non-audit services

Identified person does not have to have the SKE to perform or re-perform the services but must be able to have a sufficient understanding to oversee them

# Yellow Book Audits

If the auditor determines that no one at the unit has sufficient SKE to oversee the non-audit services being provided by the auditor, then the auditor cannot perform both the non-audit service and the audit

The responsible person does not have to be the finance officer.

The unit of government may wish to consider if the finance officer would benefit from additional training in the area or areas for which he or she does not have sufficient SKE to serve in that role.

# Yellow Book Audits

How does the Yellow Book define “acceptable level”?

An acceptable level is when a reasonable and informed third party would conclude that the firm could perform the audit without compromising its professional judgement (United States Government Accountability Office, Government Auditing Standards - 2018 Revision, pp. 37-38)

# Yellow Book Audits

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*What are sufficient safeguards? These are some examples from the 2018 Yellow Book but auditors should not consider these to be the only safeguards that can be put in place (United States Government Accountability Office, Government Auditing Standards - 2018 Revision, pp. 38-39).*

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not including individuals who provided the non-audit service as engagement team members;

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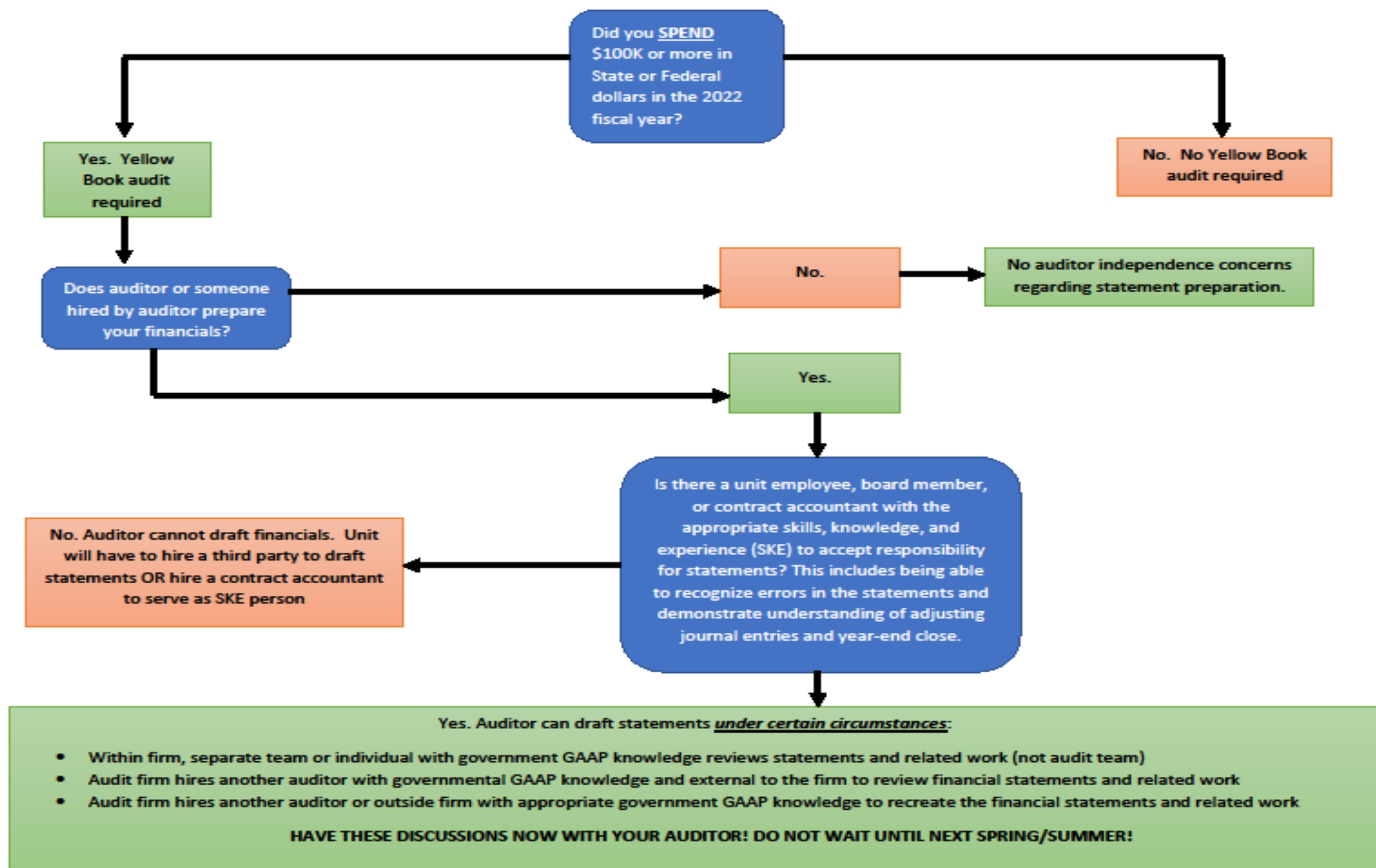
having another auditor, not associated with the engagement, review the engagement and non-audit work as appropriate;

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engaging another audit organization to evaluate the results of the non-audit service; or

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having another audit organization re-perform the non-audit service to the extent necessary to enable that other audit organization to take responsibility for the service.




# Yellow Book Audits

- GAO has identified the following bookkeeping and financial statement preparation services as threats to the auditor's independence (United States Government Accountability Office, Government Auditing Standards - 2018 Revision, pp. 51-52). **Previous guidance did not specifically call these services threats:**
  - recording transactions for which management has determined or approved the appropriate account classification, or posting coded transactions to an audited entity's general ledger;
  - preparing certain line items or sections of the financial statements based on information in the trial balance;
  - posting entries that an audited entity's management has approved to the entity's trial balance;
  - and preparing account reconciliations that identify reconciling items for the audited entity management's evaluation.

# Yellow Book Audits

What happens if auditor cannot reduce the threat to independence to an acceptable level?



If the auditor believes that sufficient safeguards cannot be applied to reduce the threat to an acceptable level, then the auditor should not perform both the non-audit service of preparation of draft financial statements and the audit

# Yellow Book Audits

Documentation is a critical step that auditors  
*must not overlook*

“If you don’t document it, it didn’t happen” is  
a good rule of thumb



# Yellow Book Audits

- What does this mean for NC local governments and their auditors?
  - May need a third party to write financials OR current auditor may draft and unit may need to find another auditor
  - Need to discuss with auditor NOW; do not wait until next summer to begin planning
  - Expect presence of ARPA dollars to increase time spent on any given audit, may reduce availability of qualified vendors to do work
  - Need to consider budget impact
  - Concerns about timely audit submission

# Yellow Book Audits

Changes present an opportunity to remind governing officials that the responsibility for the preparation and fair presentation of the financial statements in accordance with generally accepted accounting principles is with the unit's management

If the auditor assumes this responsibility, it impairs the auditor's independence. This requirement existed in the previous Yellow Book standards and has not changed

# Yellow Book Audits

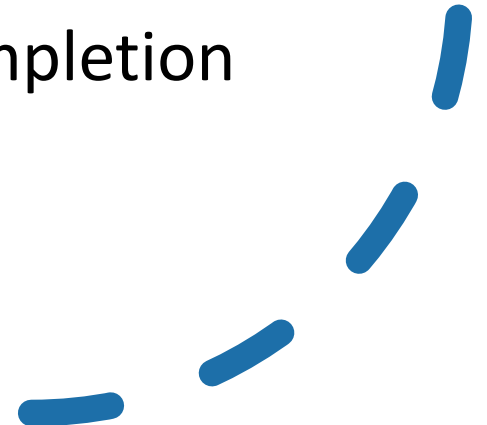
Memorandum 2019-07 *2018 Revision*  
–*Government Auditing Standards*  
(GAGAS) AKA “The Yellow Book”

Originally issued April 29, 2019

Revised memo issued June 12, 2019

# Single Audits

- For some units, ARPA dollars will push them over threshold for a Federal Single Audit **(\$750,000 or more in expenditures of federal funds** in a given fiscal year)
- ARPA funds are subject to Single Audit
- May increase amount of compliance work to be done, which translates into increased audit fees
- Concerns about timely audit completion



# Compliance and Subrecipient Monitoring

All funds subject to Yellow Book and Single Audit requirements

Restrictions follow funds so units must engage in subrecipient monitoring

Federal government can claw back funds that are misspent

Funds received by units and up to them to spend appropriately

# Compliance and Subrecipient Monitoring

- Detailed compliance guidance found here:
- <https://home.treasury.gov/system/files/136/SLF-RF-Compliance-and-Reporting-Guidance.pdf>
- UST Compliance webpage is here:
- <https://home.treasury.gov/policy-issues/coronavirus/assistance-for-state-local-and-tribal-governments/state-and-local-fiscal-recovery-funds/recipient-compliance-and-reporting-responsibilities>
- ARPA FAQs, updated regularly, here:
- <https://home.treasury.gov/system/files/136/SLF-RPFAQ.pdf>

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