



**Compliance Update 2017**  
*NC State Treasurer's NC Local Government Auditing, Reporting, and Review*

North Carolina Department of State Treasurer  
State and Local Government Finance

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June 22, 2017

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## Compliance Audit Update 2017

- Potential changes to the Yellow Book
- New standards for auditing and attestation
- Uniform Guidance (UG) requirements on internal control over compliance
- UG procurement requirements (change to implementation date)
- County audits of major State programs w/split eligibility requirements
- State Compliance Supplement 2017
- UG reporting reminders and CRP

## Changes to Yellow Book: Exposure Draft

- The Governmental Accountability Office (GAO) has released proposed changes to the governmental auditing standards (GAGAS) – better known as “Yellow Book.”
- Release of GAGAS 2017 Exposure Draft.
- GAO is inviting comment letters to the Yellow Book comments inbox.  
[YellowBookComments@gao.gov](mailto:YellowBookComments@gao.gov), no later than July 6, 2017.



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## Potential GAGAS changes: Format and Organization

- Chapters are presented in a revised format that differentiates requirements and application guidance related to the requirements.
- Chapters are reorganized and realigned:
  - Ethical principles and independent requirements are combined into a single chapter.
  - Competence and CPE are located in a single chapter.
  - Quality Control and Peer Review are located in a single chapter
- Supplemental guidance from the appendix is either removed or incorporated into the chapters.



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## Potential GAGAS changes: Independence

- Independent requirements: Engaging party and responsible party.
- Auditors should reevaluate threats to independence, including any safeguards applied, whenever the audit organization becomes aware of new information or changes in facts and circumstances that could affect whether a threat has been eliminated or reduced to an acceptable level.



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## Potential GAGAS changes: Independence (cont.)

- Auditors should conclude that any services related to preparing accounting records and financial statements, other than those defined as impairments to independence, create significant threats to auditors' independence, and should document the threats and safeguards applied to eliminate and reduce threats to an acceptable level or decline to perform the services.



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## Potential GAGAS changes: Competence and CPE

- Concept of competence:
  - Levels of GAGAS proficiency expected for different roles (entry-level, supervisory, partners and directors).
  - Application guidance: competence of specialist
- Revisions to continuing professional education:
  - New 4-hour requirement on GAGAS topics: GAGAS Qualifications (required each time GAGAS is revised).
  - Application guidance: topics required by the 80-hours GAGAS CPE requirement.
  - Detailing exceptions from the 56-hour requirement.



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## Potential GAGAS changes: Quality control

- Expanded discussion of quality control:
  - At least annually, the audit organization should obtain written affirmation of compliance with its policies and procedures on independence from all audit organization personnel required to be independent.
  - Audit organization should establish policies and procedures designed to provide reasonable assurance that the audit organization undertakes engagements only if it has the capabilities to do so.
  - Requirements are added and guidance is provided for audit performance, documentation, and reporting including requirements for policies and procedures pertaining to the review and supervision of engagement work performed by the engagement team.



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## Potential GAGAS changes: Peer review

- Expanded discussion of peer review
  - Audit organizations affiliated with a recognized organization should comply with the respective organization's peer review requirements and additional GAGAS peer review requirements.
  - Five recognized organization listed (including AICPA).
  - Standard is modified for audit organizations not affiliated with recognized organizations as follows:
    - Peer review scope is expanded to include review of documentation of terminated engagements and review of prior peer review reports, if applicable.
    - Subsequent peer reviews, the audit organization should obtain a peer review report dated not later than 3 years and 6 months from the year-end of the previous peer review.



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## Potential GAGAS changes: Financial Audits

- Auditors should consider potential internal control deficiencies in their evaluation of identified findings when developing the cause element of the identified findings when significant to the audit objectives.
- Auditors should make the GAGAS report available to users in the same manner as financial audit report in which it relates.
- The audit report on internal control and compliance with provisions of laws, regulations, contracts, and grant agreements relates only to the most recent reporting period included, when comparative financial statements are presented.



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## Potential GAGAS changes: Financial Audits (cont.)

- Auditors' are responsible for:
  - performing audit procedures to ascertain the potential effect on the audit objectives if they become aware of waste that could be significant to the audit objectives.
  - Report as findings on waste that is material.
  - Communicate findings of waste in writing of immaterial waste.
- Waste is the act of using or expending resources carelessly, extravagantly, or to no purpose. Waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight (not necessarily includes abuse or a violation of law).



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## Potential GAGAS changes: Attestation and Reviews

- Incorporated into this chapter by reference:
  - Statement on Standards for Attestation Engagements No. 18, *Attestation Standards: Clarification and Recodification*, (for auditors conducting GAGAS attestation engagements).
  - Statement on Standards for Accounting and Review Services No. 21, section 90 (*Review of Financial Statements*) (for auditors conducting GAGAS reviews of financial statements).
- Similar requirements for audit waste and reporting potential internal control deficiencies that are in GAGAS financial audits standards.



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Auditing Standards Board (ASB) issued SSAE No. 18, *Attestation Standards: Clarification and Recodification*

- Effective for reports dated on or after May 1, 2017
- Separates reporting requirements for review engagements from examination engagements
- Requires a written representation letter in all engagements
- Requires practitioners to obtain a more in-depth understanding of the subject matter to better identify risks of material misstatement in an examination engagement
- Incorporates detailed requirements that are similar to SASs
- Scope limitation imposed by the engaging party or the responsible third party.
- SSAE No 18 allows a practitioner to report on almost any subject matter as long as it meets the requirements of AT-C 105 §.25.



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Auditing Standards Board (ASB) issued SSAE No. 18, *Attestation Standards: Clarification and Recodification (cont.)*

- SSAE 18 supersedes all of the existing standards with the following exceptions:
  - AT 501, *An Examination of an Entity's Internal Control Over Financial Reporting That is Integrated With An Audit of Financial Statements*. This is now part of the Clarity Audit Standards SAS No. 130, *An Audit of Internal Control Over Financial Reporting That is Integrated With An Audit of Financial Statements*.
  - AT 701 Management's Discussion and Analysis, No changes. Now is AT-C 395.



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### SSAE No. 18 contains the following sections

- AT-C, Preface
- AT-C section 105, Concepts Common to All Attestation Engagements
- AT-C section 205, Examination Engagements
- AT-C section 210, Review Engagements
- AT-C section 215, Agreed-Upon Procedures Engagements
- AT-C section 305, Prospective Financial Information
- AT-C section 310, Reporting on Pro Forma Financial Information
- AT-C section 315, Compliance Attestation
- AT-C section 320, Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' internal Control Over Financial Reporting
- AT-C section 395, Management's Discussion and Analysis



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### Audit Standards Board: Recently issued SASs

- SAS No. 130 (formerly AT-C 501)
- SAS No. 131 – Amendment to SAS No. 122 Section 700, *Forming an Opinion and Reporting on Financial Statements Conducting an Audit in Accordance with PCAOB and GAAS.*
  - Clarifies how auditors should perform an audit under PCAOB, but not required by PCAOB standards.
  - the AICPA Code of Professional Conduct requires a GAAS audit
  - Address how reporting standards of PCAOB differ from GAAS
  - Effective for periods ending on or after June 15, 2016



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### Audit Standards Board: Recently issued SASs (cont.)

- SAS No. 132 – *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*
  - Supersedes No. 126 (same title)
  - Effective: Audits of Financial Statements for periods ending on or after December 15, 2017 and Reviews of interim financial information for interim periods beginning after fiscal years on or after December 15, 2017
- SAS No. 132 retains several concepts from SAS No. 126 including a requirement for the auditor to separately conclude whether there is substantial doubt about an entity’s ability to continue as a going concern



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### Audit Standards Board: Recently issued SASs (cont.)

- What’s in SAS No. 132 changing from No. 126?
  - Auditor’s objectives and related conclusions
  - Financial support by third parties or the entity’s owner-manager
  - Periods beyond management’s assessment
  - Use of emphasis paragraphs when substantial doubt is alleviated
  - Interim Financial information
  - Financial Statements prepared in accordance with a special-purpose framework.



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### Internal Controls (Uniform Guidance §200.303)

- The non-Federal entity **MUST**:
  - a. Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and condition of the Federal awards.
  - b. Comply with the Federal statutes, regulations, and the terms and condition of the Federal awards.
  - c. Evaluate and monitor compliance
  - d. Take prompt action when instances of non-compliance are identified
  - e. Take reasonable measures to safeguard personally identifiable information and other sensitive information.



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### Internal Controls (Uniform Guidance §200.303) cont.

- Internal controls **SHOULD** be in compliance with:
  - ✓ COSO (“Internal Control Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission)
  - ✓ Green Book (“Standards for Internal Control in the Federal Government,” issued by the Comptroller General of the United States.
- **MUST** is not optional.
- **SHOULD** is recommended
- Risk Assessment and Response to Assessed Risk audit standards (AU-C §300-499) apply to compliance audits except for selected individual paragraphs listed in AU-C §935.



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## OMB Compliance Supplement: Part 6 Internal Control

- Addresses the objectives, principles, and components of internal control based on the COSA integrated framework and the Green Book.
- Information on internal control in Part 6 of the OMB Compliance Supplement is general in nature than in guidance to 2015.
- Should be used for planning and performing the audit, but is not a checklist of required internal control characteristics.
- An non-federal entity could have adequate internal control even though some or all of the characteristics are not present.
- Non-Federal entities will need to exercise judgment in determining the most appropriate and cost-effective internal control in a given environment or circumstance, to provide reasonable assurance of compliance with Federal program requirements.



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## Components & Principles of Internal Control

Components	Principles
A. Control Environment	<ol style="list-style-type: none"> <li>1. Demonstrate Commitment to Integrity and Ethical Values</li> <li>2. Exercise Oversight Responsibility</li> <li>3. Establish Structure, Responsibility and Authority</li> <li>4. Demonstrate Commitment to Competence</li> <li>5. Enforce Accountability</li> </ol>
B. Risk Assessment	<ol style="list-style-type: none"> <li>6. Define Objectives and Risk Tolerances</li> <li>7. Identify, Analyze, and Respond to Risks</li> <li>8. Assess Fraud Risk</li> <li>9. Identify, Analyze, and Respond to Change</li> </ol>
C. Control Activities	<ol style="list-style-type: none"> <li>10. Design Control Activities</li> <li>11. Design Activities for the Information System</li> <li>12. Implement Control Activities</li> </ol>
D. Information and Communication	<ol style="list-style-type: none"> <li>13. Use Quality Information</li> <li>14. Communicate Internally</li> <li>15. Communicate Externally</li> </ol>
E. Monitoring	<ol style="list-style-type: none"> <li>16. Perform Monitoring Activities</li> <li>17. Evaluate Issues and Remediate Deficiencies</li> </ol>



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## Components & Principles of Internal Control (cont.)

- Expansion of Components and Principles:
  - Characteristics (OMB Compliance Supplement, Part 6 Internal Control)
  - Point of Focus (COSO Integrated Framework)
  - Attributes (GAO's Green Book)
- Process vs. Control?
  - Auditors need to be able to detect a process vs. a control.
  - Processes are procedures that originate, transfer, or change data.
  - Controls are procedures designed to prevent, detect and correct errors resulting from processing of accounting information



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## Procurement Grace Period Extended

- OMB issued a correcting amendment to the Uniform Guidance (*Federal Register* May 17, 2017) to allow a one year grace period for non-federal entities to implement changes to their procurement policies and procedures found in Uniform Guidance §200.317 - §200.326.
- Implementation date for the procurement standards will start for fiscal years beginning on or after December 26, 2017 (July 1, 2018 for most NC local governments) for those entities choosing to take advantage of the extension.
- Non-federal entities and their auditors are also reminded that non-federal entities are required to document their decision to choose to use the previous procurement standards during the extension period (UG §200.110).



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## Implementing UG Procurement Standards

- UNC-School of Government question to OMB (May 25, 2017)
  - “Must a non-federal entity (in this case, local governments in North Carolina) reprint verbatim the procurement requirements of 2 CFR 200.317 through 200.326 into their own local procurement policies, or would a more general statement of compliance with all federal regulations applicable to federal grant funds be sufficient?”
  - “NFEs have the flexibility to incorporate the UG’s procurement requirement verbatim or simply reference it in their procurement policies. A general statement about how “procurements must conform to applicable Federal law and standards” should suffice.”



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## Understanding UG Procurement Standards

- Comparison of Federal and State Procurement Requirements for NC Local Government (UNC-SOG)
  - Refer to handout
- Some of the general standards (§200.318) over procurement include:
  - Every non-federal entity receiving federal awards must have its own documented procurement procedures that reflect State, local and federal law.
  - Written conflict-of-interest policies are required. No employee or agent of the entity may participate in the selection, award, or administration of a contract funded by federal grant dollars if he or she has an actual or apparent conflict of interest. (Conflict of interest §200.312)



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### UG Procurement General Standards (cont.)

- Oversight of contractors to ensure that contracts are performed in accordance with contract terms, specifications, and POs.
- The organization must document the procurement steps and activities required to be completed. This includes the basis for the type of procurement, contract type, and the basis for the contractor selection and price.
- Consideration should be given to obtain a more economical purchase. Avoid purchase of unnecessary or duplicate items. Consider shared services and intergovernmental agreements to foster greater economy and efficiency.



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### Procurement Standards – Competition (§200.319)

- All procurement must be conducted in a manner providing full and open competition consistent with the standards of this section.
- In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, or invitations for bids or requests for proposals must be excluded from competing for such procurements.



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### Procurement Standards – Competition (§200.319) (cont.)

- Procurements must be conducted in a manner that prohibits the use of geographical preferences in the evaluation of proposals, except in certain case where federal law explicitly requires or encourages geographic preference or when contracting for architectural and engineering services, provided that specifying geographic location leaves an appropriate number of qualified firms.



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### Methods of Procurement (§200.320)

- Micro-purchases – aggregate dollar amount does not exceed \$3,500 (Davis Bacon \$2,000).
- Small Purchase procedures – up to the Simplified Acquisition threshold (SAT) - \$150,000.
- Seal bids (formal advertising) over SAT.
- Competitive proposals – over SAT.
- Noncompetitive (sole-source) – only when a single source is available, public emergency situations, when a federal agency authorizes it, or competition is deemed inadequate.



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## 2017 State Compliance Supplements

- State Compliance Supplement for State programs/projects posted May 1, 2017;
  - Must wait for OMB Compliance Supplement (Section A) to complete audit of federal programs
- OMB Releases Draft 2017 Compliance Supplement for Use in Audit Planning (refer to GAQC #336, June 6, 2017)
- Final issuance of OMB Compliance Supplement is uncertain
  - Revised to address the recent one year additional one year delay on procurement



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## OMB Compliance Supplement

- “Other Information Section” (Section IV) of the Individual programs in the OMB Compliance Supplement.
  - Auditees should read compliance supplement
- Part 7 – Guidance for auditing programs not included in this compliance supplement
- Appendix I – Federal programs excluded from the A-102 and portions of 2 CFR 200
- Appendix III – Federal Agency Single Audit, Key Management Liaisons, and Program Contacts
- Appendix V – List of Changes for the 2017 Compliance Supplement
- Appendix VII – Other Audit Advisories



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## County Audits – OSA Designated Programs

- State of NC Major Federal Programs with split eligibility determination process with Counties for 2017
  - Medicaid (93.778) and Adoption (93.659)
  - Both determined to be high-risk
  - OSA has prepared Medicaid Eligibility Sampling Instructions and Adoption Eligibility Testing Attributes
- CPA Representation Letter, Turnaround Document, and Eligibility Error Documentation required to be submitted with audits to LGC
- OSA resources: FAQ –OSA Documents,
- Audit required to be submitted to LGC no later than November 30, 2017



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## County Audits – DHHS resources

- DHHS documents to aid in testing of Medicaid (93.778) and CHIPs (93.767) are now located at the State Compliance Supplement website, Section B under the Medicaid (93.778) State Compliance Supplement
- Documents included:
  - Eligibility Review Document - Medicaid / NC Health Choice
  - Attachment - Eligibility Review Document
  - DHHS CPA Data Request Document
  - Powerpoint Presentation for Eligibility Review Document



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## Uniform Guidance Second Year Reminders

- Revised criteria for both high risk Type A and B programs
- Change in major program determination – selection of Type Bs
- Low Risk Auditee determination
  - Data collection form filed timely
  - Unmodified opinions
- SEFSA reporting
  - Cluster of program reporting (should have a total amount)
  - Subrecipient reporting (not as a footnote, but on the schedule)
  - Loan and loan guarantee programs



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## Schedule of Federal and State Awards (SEFSA)

- Total presented for cluster of programs. If a State cluster than includes a federal cluster (ex. Subsidized Child Care) there needs to be a total for the federal cluster and a total for the entire cluster.
- Loans and loan guarantees are to be reported in both on the schedule (expenditures in accordance to UG §200.510(b)(5)) and in the notes to the SEFSA (balance of the loan at fiscal year end).
- Subrecipients are to be reported on the schedule, no longer as a footnote (AICPA recommends an additional column).



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## Common Deficiencies in the SEFSA

- Amounts reported on the SEFSA did not reconcile to the financial statements.
- The Schedule did not indicate whether the awards were direct or pass-through.
  - This may be allowed if a proper pass-through entity identifying number is included.
- Schedule did not indicate the total federal expenditures and/or State expenditures. Total for federal or State programs were not correctly reported.
- Did not include or included incorrect Federal and/or State agency name, CFDA or other identifying number, program name
- Inadequate or no notes
- Significant accounting policies used in prepared the schedule were not included.



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## FEMA - Public Assistance Grants SEFSA reporting

- Non-Federal entities must record expenditures on the SEFA when:
  1. FEMA has approved the non-Federal entity's Project Worksheet (PW), and
  2. the non-Federal entity has incurred the eligible expenditures. Federal awards expended in years subsequent to the fiscal year in which the PW is approved are to be recorded on the non-Federal entity's SEFA in those subsequent years.



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## FEMA - Public Assistance Grants reporting (cont.)

- For example:
  1. If FEMA approves the PW in the non-Federal entity's fiscal year 2014 and eligible expenditures are incurred in the non-Federal entity's fiscal year 2015, the non-Federal entity records the eligible expenditures in its fiscal year 2015 SEFA.
  2. If the non-Federal entity incurs eligible expenditures in its fiscal year 2014 and FEMA approves the non-Federal entity's PW in the non-Federal entity's fiscal year 2015, the non-Federal entity records the eligible expenditures in its fiscal year 2015 SEFA with a footnote that discloses the amount included on the SEFA that was incurred in a prior year.



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## Reporting CWSRF and DWSRF on the SEFSA

- Clean Water State Revolving Fund (66.458) and Drinking Water State Revolving Fund (66.468) amounts are awarded by EPA to States as grants. The States then makes subawards in the form of loans to its subrecipients.
- Therefore, in determining the amount of Federal funds expended to be reported on the SEFA, subrecipients receiving CWSRF or DWSRF loans, should include project expenditures incurred during the year (do not include loan balance from previous year or interest subsidy, cash, or adm. cost received)
- These are subawards—not direct Federal loans—and, therefore, neither 2 CFR sections 200.502(b) or (d) apply when calculating the amount of Federal funds expended.



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## State Single Audit Requirements

- Local governments and public authorities with fiscal year ends June 30, 2016 or later that has expended \$500,000 or more of State financial assistance must have a single audit in accordance with the State Single Audit Implementation Act.
- A single State financial assistance program with expenditures of \$500,000 or more must be audited as major if it is determined to be high risk using the criteria for federal program risk found in Section 519 of OMB Uniform Guidance (or refer to page 35-E-31). A program may be considered low risk if it was audited as major in at least one of the two most recent audit periods
- State awards audited as major must be 40% of total State awards expended.



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## State Compliance Audit Requirements (cont.)

- Local governments and public authorities that expend \$100,000 or more in combined federal or State financial assistance must have an audit performed in accordance with Government Auditing Standards (GAGAS).
- Audits of NPOs in North Carolina:
  - Are subject to the audit requirements found in G.S. §143-6-22, §143-6-23 and NC Administrative Code (09 NCAC 03M .0205)
  - Questions may be address at [www.NCGrants.gov](http://www.NCGrants.gov), Contact Us (NC Grants Administrator)



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## LGC Review of Audit Reports

- Number of audits reviewed by LGC for fiscal years ending in 2016: \*1,213 audits

570 Single Audits (47%)

256 GAGAS only (21%)

387 GAAS only (32%)

\* received as of June 15, 2017



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## Common Compliance Reporting Problems

- Compliance reports reporting of findings does not tie to the schedule of findings and questioned costs (SFQC)
- Schedule of Expenditures of Federal and State Awards is not properly referenced in the auditor's opinion:
  - Supplementary info (other matters)
  - SEFSA is included with no single audit
- Yellow Book report's opinion units do not tie opinion units reported in the auditor's opinion or what is reported in the financial statements
- Findings do not include all the required elements:
  - Findings are included in the report and not in separate schedule
  - Does not include criteria, cause, or repeat finding



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## Common Compliance Reporting Problems

- Names of programs located in “Identification of major Federal and/or State programs” do not tie to SEFSA
- Questioned costs are not given or explained why there were none
- Corrective Action Plan is missing name of contact and/or anticipated completion date
- Schedule of prior period audit findings is not clear on the finding status or is missing a finding from prior year
- Data Collection Form has not been filed timely
- A Federal program that was part of a cluster was not included in testing major programs
- Auditors Communication with Those Charged With Governance (AU-C §265) report should include information in “identification of significant difficulties encountered during the audit.”



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