

Office of the State Auditor



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State of North Carolina:
Chief Executive Officers
Chief Financial Officers

Dear Sir/Madam:

State agencies are required by *North Carolina General Statute 147-64.7(b)(2)* to obtain prior approval from the State Auditor of all contracts for auditing services that may impact the State's financial statements. Further, the law provides that the State Auditor will prescribe policy and establish guidelines containing criteria for selecting auditors.

The procedures that state agencies should follow when procuring auditing services are described below. The procedures apply whenever an organization is required to be included in the State's *Comprehensive Annual Financial Report* either as part of the primary government or as a component unit. Component units are legally separate organizations that are required by generally accepted accounting principles to be included in a government's financial statements.

The Office of State Controller determines which organizations are included in the *Comprehensive Annual Financial Report*. However, if organizations are technically required to be included in the *Comprehensive Annual Financial Report*, but the Office of State Controller does not include them based on their relative immateriality, those organizations still must comply with the requirements presented below.

Therefore, the requirements apply to all state agencies, universities, community colleges, public authorities, not-for-profit organizations, foundations included in university or college financial statements, licensing boards, or any other entities that are supposed to be included in the State's *Comprehensive Annual Financial Report*. If you have affiliated organizations that are part of your reporting entity (e.g. university and college foundations), please share this letter with those organizations.

This letter serves to outline the process for contracting for audit services and list the required provisions for those contracts. It does not authorize state agencies or universities to contract with private CPA firms to complete their Single Audit work or their portion of the State's Comprehensive Annual Financial Report. Authorization to contract with a private CPA firm for this work can only come from state statute or from specific authorization from the Office of the State Auditor.

Required Procedures for Procuring Auditing Services from Private Certified Public Accountants

1. Contracts should be awarded for one year with the option to renew by the audited organization each year for up to two additional years. Therefore, the following procedures should be employed at least once every three years. After a contract is awarded, organizations can renew the contract without soliciting bids until the three-year term has expired. After three years, audits must be re-bid.
2. The organization should solicit proposals for auditing services in two parts: a technical proposal and a cost proposal. The bid solicitation document (i.e. requests for proposals) should include all the required contract provisions listed in the section below.
3. The technical proposal should describe the scope of services to be provided under the contract (see contract requirements below) and the auditor's experience and qualifications to perform the audit. At a minimum, the technical proposal should include: (a) a list of key personnel who will perform the audit and their qualifications; (b) the anticipated staff hours to be used in conducting the audit; (c) a list of similar clients audited by the firm and the length of time that the firm has audited each; (d) the firm's most recent peer review report; and (e) a description of any regulatory actions taken against the firm or key personnel in the last three years.
4. The cost proposal should itemize the amount expected to be billed for the audit, describe the billing arrangements, and contain a maximum not to exceed amount for the total term of the contract.
5. The technical proposals should be reviewed and evaluated before considering cost proposals. Organizations should identify the firms that are most qualified to perform the audit and then consider cost proposals from those firms. The first priority in evaluating proposals must be obtaining a quality audit. In making this determination, the organization should consider the information in the technical proposal (including the anticipated staff hours to be used in conducting the audit), as well as the firm's reputation and history of providing quality auditing services to the organization or similar clients.
6. When identifying firms as most qualified, the organization should consider deficiencies disclosed in proposing firms' most recent peer review reports. Unless there are no alternatives, organizations should not contract with firms whose most recent peer review report contains a Fail rating. Organizations should eliminate from consideration any firm that has not had a peer review covering one of the past three years (note that there may be a time lag between the review period and issuance of the report).
7. Organizations should select the firm that provides the best overall value, which may not be the least expensive choice. Before accepting a bid with a cost that is substantially lower than the average price of all bids received or a price quoted by the Office of the State Auditor (if applicable), organizations must specifically consider whether there is a reasonable justification for the price differential, document the consideration, and submit the documentation to the Office of the State Auditor for review.
8. The provisions above are in addition to any other requirements that must be complied with by the audited organization. Whenever there is a conflict between the above provisions and other requirements, the more restrictive requirement shall take precedence.

Required Contract Provisions

1. The financial statements will be audited in accordance with auditing standards generally accepted in the United States of America. If the organization spends more than \$500,000 in combined federal and/or state financial assistance (e.g. contracts and grants), the audit must also be conducted in accordance with the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States.
2. The audit scope will include a determination as to whether the financial statements are presented in accordance with the appropriate accounting principles for the organization (i.e. GASB or FASB). The contract shall also acknowledge that statewide accounting policies are established by the Office of State Controller, and thus, apply to the organization.
3. Audit contracts will include the requirement from North Carolina General Statute §147-64.6D: "Each audit report prepared for a State agency by a Certified Public Accountant shall itemize the number of hours used in conducting the audit and in preparation of the audit report and the total cost of conducting the audit and preparing the audit report." For purposes of consistency, this cost disclosure must be presented **on the last page** and **not as the final note in the Notes to the Financial Statement section** of the audit report. It must be in the following format:

"This audit required _____ audit hours at a cost of
\$ _____."

Additional information may be provided in the hours/cost disclosure so long as the above sentence is included.

4. The Office of State Auditor will be permitted to review the audit documentation for the engagement and such audit documentation will be retained for a period of at least three years.
5. One electronic copy of all audit reports will be submitted to the Office of the State Auditor and an additional electronic copy will be submitted to the Office of State Controller (hard copies are no longer required).
6. Audit contracts will specify all applicable report issuance deadlines.
 - If the Office of the State Auditor needs the report to support the opinion rendered in the *Comprehensive Annual Financial Report* or another audit report, the affected organization will be informed on an individual basis of this fact and of the required reporting deadlines.
 - The Office of State Controller's policy on *Submission of Audit Reports* is available at:
http://www.ncosc.net/sigdocs/sig_docs/documentation/policies_procedures/sigState_Financial_Reporting.html
 - State organizations may have other audit report issuance deadlines imposed by governing boards, grant providers, debt covenants, etc.

This Letter May Be Considered as Prior Approval of Contracts for Some Entities

Except for the entities specifically identified below, this letter acts as prior approval for you to enter into contracts for auditing services affecting the State's financial statements. If you are not one of the listed organizations, you do not have to submit your contract to the Office of the State Auditor for review. **Please note, this paragraph does not apply to Council of State or Cabinet departments or agencies.**

This approval is only valid so long as the required procurement procedures and contract provisions described above are used. The Office of the State Auditor may request evidence that you have met these requirements.

Contracts Requiring Advance Approval

Audit contracts for the following entities must be specifically approved in advance by the Office of the State Auditor:

- a. Community Colleges (excluding foundations if they are audited under separate contracts)
- b. 401K Supplemental Retirement Income Plan
- c. N.C. Deferred Compensation Plan
- d. N.C. Railroad Company
- e. Individual entities that comprise the UNC Health Care System (UNC Hospitals – Rex Healthcare, Chatham Hospital, UNC Hospitals Liability Insurance Trust Fund, etc.)
- f. Golden LEAF, Inc.
- g. N.C. Housing Finance Agency
- h. State Education Assistance Authority
- i. N.C. Biotechnology Center
- j. Centennial Authority
- k. N.C. Turnpike Authority
- l. Economic Development Partnership of North Carolina
- m. N.C. Teachers' and State Employees' Comprehensive Major Medical Plan Claims Audit

For these entities, an audit should not be started before the contract is approved by this Office. Prior to executing a contract for auditing services, you must submit to us: (a) any new contract(s) or contract amendment(s); and (b) a copy of the contract auditor's most recent peer review report. You do not have to submit to us the contract extensions executed during the three-year period covered by the contract unless the extensions also significantly alter the contract terms. We will provide contract approval by correspondence.

All contracts and other information required by this letter should be submitted to the attention of Mr. Tim Hoegemeyer, General Counsel, Office of the State Auditor. Please contact Mr. Hoegemeyer at (919) 807-7670 or Tim_Hoegemeyer@ncauditor.net if you have any questions regarding these procedures. If you have any questions regarding any Office of State Controller's reporting requirements, please contact Mr. Clayton Murphy at (919) 707-0525.

Sincerely,



Beth A. Wood, CPA
State Auditor