

Audit Program for Conflicts of Interest /Self-Dealing For North Carolina Local Government Units And Public Authorities

The audit program below is provided to supplement other audit programs which already address conflicts of interests, by suggesting audit procedures within the context of the North Carolina General Statutes (G.S.). This program should aid the auditor in identifying items that may be violations of State law or evidence of internal control weaknesses. Many of the steps and procedures below may be done in conjunction with other audit procedures. Please read the suggested procedures before beginning the audit work. Also, auditors should be familiar with the “small unit exceptions,” detailed below. References to “the unit” or “the local government” are not meant to, and do not, exclude public authorities, or auditors of public authorities, from using the following suggested audit procedures. This audit program is not intended to be all inclusive; professional judgment should be used in determining the extent of tests and the use of procedures not included herein. The General Statutes of North Carolina and 2001 Session Laws updating the statutes are available on the web site of the North Carolina General Assembly, www.ncga.state.nc.us/. **Because G.S. 14-234 is a criminal statute, the auditor and the unit’s management should seek the opinion of the unit’s attorney if audit procedures indicate that an individual has used his/her position to receive a personal benefit for himself/herself or for his/her spouse.**

- A. **Planning and Preparation** - Determine what standards may apply to potential conflict of interest situations.

In addition to the North Carolina General Statutes, what other guidelines may apply to the unit?

Are there grant or loan agreements which include conflict of interest clauses?

Is there a locally adopted policy on conflicts of interest? Note that this is required of charter schools. (State Board Policy EEO-U-006)

- B. **Sufficient Evidential Material** - Consider the following for gathering sufficient evidentiary matter. These audit procedures may easily be incorporated into or with other audit procedures.

Monetary Benefits

Read the minutes of the governing board. Generally, the smaller the unit, the more likely related party transactions are to occur. Look for instances that a governing board member has properly excused himself/herself from voting

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because of a conflict of interest. If such actions are noted throughout the year, test the amounts paid to the governing board member. Are the amounts paid within the statutory limits? (Small unit exceptions detailed below.)

Examine the check register or disbursement records for payments to members of the governing board. Test that these are within the allowable limits. Payments to governing board members or employees that are reimbursements of travel, training, or other such payments where the payee does not receive a financial benefit are allowable and not subject to these guidelines.

Examine the check register or disbursement records for recurring payments to unidentified individuals or local businesses. Consider if the payee may be the spouse of a governing board member or the spouse of a management official. The NC Secretary of State's web site, [NC Secretary of State Corporations Division](#), contains imaged copies of articles of incorporation and annual filings. This resource may provide additional information about corporate officers, to determine if undisclosed related party transactions may have occurred.

Consider if the unit is paying more than arm's length rates for essential services. Consider further audit procedures to determine the nature of the transaction. (This may be a management letter comment to alert management that additional savings could be available.) Are the payments made from federal or State financial assistance, which could limit the amount paid for services? *Consider if some of this testing could be combined with audit procedures testing compliance with purchasing statutes.*

Non-monetary benefits

Auditors should be alert to evidence suggesting that some individuals may be receiving additional benefits because of their position within the local government unit. Auditors should be alert for instances where the quantity or quality of equipment is substantially more than is typical. Also, higher than typical fuel usage or maintenance may suggest individuals may be using equipment for personal purposes. While the degree of benefit may not be precisely measurable, the use of public property to benefit one or more individuals fails to be an expenditure for a "public purpose." Expenditures that are not for public purposes should not be made. Auditors should be alert for evidence of additional benefits going to certain individuals.

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C. Special Situations

Determine if any of the exceptions listed in the state laws or other conflict of interest documents apply. [Consider using the checklist published in Section 20-B to clarify if a related party transaction is covered by an allowable exception.]

Is the unit small enough to qualify to allow transactions with governing board members, subject to the limits of G.S. 14-234(d1)? [7,500 population prior to April 1, 2002; 15,000 population there after based on the 2000 Census.] Auditors are strongly urged to review the situations in G.S. 14-234(d1) where related party transactions are allowed, on a very limited basis. Auditors should also be aware that these exceptions are not available if the contract is for purchases or construction that is covered by the formal or informal bidding requirements [G.S. 14-234(d2)].

Were the dollar amount limitations observed in the related party transactions? [\$20,000 for medical services provided over a twelve month period. \$40,000 for goods or services provided over a 12 month period.]

Are there any other conflict of interest policies that list any relevant exceptions from the policy? Generally, no local policy or federal statute could make the exceptions for related party transactions broader. Local policies or other guidance may possibly further restrict the related party transactions that are allowable.

Special Considerations for Charter Schools

Because the charter for a North Carolina charter school is held by a local sponsoring nonprofit organization, it is very possible that the independent auditor will find transactions between the local school and the supporting nonprofit organization. These transactions may be at arms length and there may not be a related party involved. Auditors should consider if additional inquiries are appropriate to determine if vendors and/or service providers may be receiving financial benefits because of their relationship to a member of the non-profit organization or the charter school officials. When determining the extent of substantive tests, auditors should remember that charter schools may lose (and some have lost) their charter for financial mismanagement.

As noted earlier, the local governing boards of charter schools are required to adopt a conflict of interest policy. The auditor should review the compliance supplement from DPI for charter schools. If the compliance requirement is just to confirm that the governing board has adopted a conflict of interest policy, the auditor may consider if testing the unit's compliance with its own locally adopted conflict of interest policy could serve as a test of the internal control environment.

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- D. **Reporting** - If conflict of interest situations or related party transactions were noted during audit review procedures, consider the following factors when determining how to report the results of the field work.

If there has been a material statute or contract violation because of a conflict of interest or a related party transaction, that fact should be disclosed in the notes to the audited financial statements. The notes should disclose any material related party transactions and any associated receivables from the related party.

If a material statutory violation has occurred and the audit is performed in accordance with Government Auditing Standards, the auditor should consider if the statutory violation should be disclosed as a finding . The auditor should make similar determinations if the audit was done under Single Audit standards, in accordance with the U.S. Office of Management and Budget Circular A-133. If there is a conflict of interest finding related to a specific program, then a disclosure should be made in the appropriate compliance report.

If a conflict of interest situation or related party transactions have been discovered as a result of audit procedures, the auditor should consider if this is evidence of a reportable condition or material weakness in internal controls.

Finally, if an auditor has evidence that a conflict of interest situation exists or did exist, but the situation is such that financial statement note disclosure is not appropriate nor is inclusion in the compliance reports, the auditor should consider including a description of the situation in the management letter.