

This is in response to the Iowa Office of Auditor of State's letter dated April 20, 2020. We have gathered information addressing the questions that were raised.

1. Should the Office of Auditor of State costs be in Iowa SWCAP

Even though the Office of Auditor of State is not established as a true ISF, it uses a billing mechanism to assign costs to State agencies. Therefore, the services are covered by 2 CFR 200 (formerly OMB Circular A-87). Below is the excerpt from ASMB C-10. We underlined some key words.

**4-6 Attachment C, paragraph E.3.b. identifies the requirements for the submission of information to the cognizant agency concerning internal service funds (ISFs). What is the definition of an ISF?** [Att. C, ¶ E.3.b(1)]

The definition is provided in generally accepted accounting principles, i.e., a fund used "to account for the financing of goods or services provided by one department or agency to other departments or agencies of a government or to other governments, on a cost-reimbursement basis." (*Codification of Standards of Governmental Accounting*, 1300.104. Governmental Accounting Standards Board.) Internal Service Funds (ISFs) would be separately recognized in the financial statements using the accrual basis of accounting. However, this section of A-87 covers more than ISFs for central service activities of a state or local government. It covers the submission requirements of all central service activities for which the state or local government uses a billing mechanism (formal or memo billing) to assign or allocate costs to other components of the respective government. This requirement applies whether or not the "billed" activity is established in the unit's financial statements as a true ISF under generally accepted accounting principles.

In addition, 2 CFR 200, Appendix V, C. states: "The central service cost allocation plan will include all central service costs that will be claimed (either as a billed or an allocated cost) under Federal awards and will be documented as described in section E. Costs of central services omitted from the plan will not be reimbursed."

If State Auditor costs are not included in the SWCAP, then the State agencies may not charge any State audit costs, including the Single Audit, to Federal programs as a direct or indirect charge.

2. Is the reconciliation required to include non-billed work (i.e., imputed revenue)

Imputed revenue should be included in the reconciliation schedule per ASMB C-10, Instructions for Preparing the Reconciliation of Retained Earnings (R.E.) Balance to Federal Guidelines (Illustration 4-7). See excerpt below.

**Part I A-87 R.E. Balance**

2. **A-87 Revenues.** Revenues shall consist of all revenues generated by the service, including unbilled and uncollected revenues. If some users were not billed for services (or were not billed at a full rate), a schedule showing the full imputed revenues associated with these users shall be provided (see Summary of Actual

and Imputed Revenues - Illustration 4-6). Revenues should also include (i) all other revenues the fund earned from its operation, and (ii) interest earned on reserves. If imputed interest/investment earnings are shown at the bottom of the schedule, these amounts should not be included in this section.

3. Is the reconciliation required to include imputed revenue for admin services that were not billed to non-State agencies

During past review, we were provided a description of billing methodology. It indicated that the State agencies and local governments were billed at the same rates. During our current review, we have learned that the state agencies are billed at a higher rate, and that the local governments are not billed for admin services.

In the revised methodology description provided by State email dated 2/19/2020, it still states that the users are billed at the same rates. The description of methodology is still misleading (see paragraph below):

“This results in all state agency and local government audit work being charged at the same rates for each audit staff level performing the audit work, regardless of whether the cost is being paid by a state agency from state appropriations to the agency, by a local government, from federal funds received by the agency or local government or from the state appropriation to the Office of Auditor of State.”

The letter explains that “because local governments are not obligated to choose our office, there are administrative costs our office incurs that we do not feel are fair to bill to those local governments. Those costs include the costs associated with maintaining an office and administrative staff that are needed because we are required to audit the State’s CAFR and Single Audit. In addition, our office is a public body with a public mission that suggests we should keep our rates competitive on the market to ensure we are accessible to local governments, and low enough that disadvantaged cities and towns are able to afford the audits they are obligated to have.”

While we understand that the Iowa Office of Auditor of State wants to maintain a competitive rate in order to retain local governments and bring in revenues, we have an obligation to make sure that the Federal programs are not subsidizing the cost for the non-Federal program billing. We are required to determine if all users (including outside the governmental entity) are billed the same rate for the same service (*CAS Best Practices Manual for Reviewing State and Local Government Proposals*).

The administrative office and staff are responsible for providing administrative support to the auditors, whether the auditors are conducting audits on state agencies or local governments. The auditors will still need administrative support while performing audit on local governments. Therefore, it is not fair for the State agencies to pick up all the administrative costs that benefit the local governments.

Imputed revenue should be included in the reconciliation schedule for administrative services that were not billed at a full rate per ASMB C-10, Instructions for Preparing the Reconciliation of Retained Earnings (R.E.) Balance to Federal Guidelines (Illustration 4-7). See excerpt below.

### **Part I A-87 R.E. Balance**

2. **A-87 Revenues.** Revenues shall consist of all revenues generated by the service, including unbilled and uncollected revenues. If some users were not billed for services (or were not billed at a full rate), a schedule showing the full imputed revenues associated with these users shall be provided (see Summary of Actual and Imputed Revenues - Illustration 4-6). Revenues should also include (i) all other revenues the fund earned from its operation, and (ii) interest earned on reserves. If imputed interest/investment earnings are shown at the bottom of the schedule, these amounts should not be included in this section.

#### 4. Reduced expenditures for unallowable legislative and performance audits. Should revenue be reduced for like amount

Our guidance has not changed on the reconciliation. We still follow ASMB C-10, Illustration 4-7 Reconciliation of Retained Earnings, and the Instructions for Preparing the Reconciliation of Retained Earnings Balance to Federal Guidelines.

Per the guidance, revenues shall consist of all revenues generated by the service, including unbilled and uncollected revenues.

The initial expenditures should reconcile to the CAFR (or other financial records). Then adjustments should be made to exclude unallowable expenditures.

We understand that by reducing expenditure but not revenue will likely produce excess fund balance. If the revenue did not come from Federal funds directly or indirectly, the State would not owe the Federal government anything on this portion of the excess because there is no Federal financial participation.

During our review, we were advised that the top three State agencies that were billed for the unallowable costs did not use Federal funds to pay. Based on this information, we agree to reduce the revenue for like amount under the condition that the State has control in place to prevent the Federal funds from paying directly or indirectly into the unallowable activities.

#### 5. Specific recommendations on how to proceed to correct the problems, not only for this reconciliation but for all future reconciliations

The letter indicated that the State auditors will try to get legislative approval to bill all user agencies and bill all users (State agencies and local governments) at the same rate. If the State Legislature approves the changes, the problems identified in the current review will be corrected.

In the meantime, we will need to continue to calculate the imputed revenues on unbilled services, and services that are not billed at the full rate. We understand that the imputed revenue will likely increase the retained earning balance. To address any excess retained earnings balance, the options provided by ASMB C-10, Illustration 4-7 Reconciliation of Retained Earnings, and the Instructions for Preparing the Reconciliation of Retained Earnings Balance to Federal Guidelines are:

**Excess Balance.** The Federal share of the excess must be returned to the Federal Government. Exceptions are based on negotiator judgment. For example, the state could credit the appropriate Federal and state programs/agencies for the overcharged amount, or the future billing rates could be reduced.

The followings are possible options that the State may consider regarding excess balance:

Option 1 – Refund for the Federal share on excess balance. As an example, after including the imputed revenues, we estimated that the excess fund balance is \$624,000 for FYE 06/30/17. We estimated that the federal financial participation (FFP) is 8%. This means that the Federal's share of the excess fund balance is estimated at \$49,920 ( $\$624,000 \times 8\%$ ). The State will need to provide the support for actual FFP.

Option 2 – Credit the appropriate Federal and state programs/agencies for the overcharged amount. The State will need to identify a methodology to credit the appropriate Federal programs for the Federal's share. The State will need to provide supporting document to our office to show that the Federal programs are credited properly.

Option 3 – Adjust future billing rates. The State will need to propose how to adjust future billings rates to reduce excess fund balance.

If the State has other possible solutions, we are open for discussion. We understand that the State had worked with our office in the past on issues involving the reconciliation schedules. We will continue to work with the State to find an acceptable solution.