

Report To

The Mississippi Legislature



**A REVIEW OF AUDIT FEE ADJUSTMENTS AND CHARGE-OFFS
BY THE OFFICE OF THE STATE AUDITOR
JULY 1, 1984, THROUGH DECEMBER 31, 1988**

June 20, 1989

The Office of the State Auditor is authorized by law to audit any entity which shares revenues derived from taxes or fees imposed by the Legislature and other public bodies supported in part or wholly from public funds. The Department of Audit made audit fee charge-offs totaling \$73,614.89 from July 1, 1984, through December 31, 1988, without written policies, procedures, and criteria to govern the billing of audit fees. Of this amount, the department did not charge governmental entities \$28,952.52 for audit services during this period as required by state statutes. PEER recommends that the Department of Audit verify time records supporting the \$28,952.52 in uncollected fees and collect those determined to be correct. The Department of Audit should develop written policies and procedures to govern the billing process.

The PEER Committee

PEER: THE MISSISSIPPI LEGISLATURE'S OVERSIGHT AGENCY

The Mississippi Legislature created the Joint Legislative Committee on Performance Evaluation and Expenditure Review (PEER Committee) by statute in 1973. A standing joint committee, the PEER Committee is composed of five members of the House of Representatives appointed by the Speaker and five members of the Senate appointed by the Lieutenant Governor. Appointments are made for four-year terms with one Senator and one Representative appointed from each of the U. S. Congressional Districts. Committee officers are elected by the membership with officers alternating annually between the two houses. All Committee actions by statute require a majority vote of three Representatives and three Senators voting in the affirmative.

An extension of the Mississippi Legislature's constitutional prerogative to conduct examinations and investigations, PEER is authorized by law to review any entity, including contractors supported in whole or in part by public funds, and to address any issues which may require legislative action. PEER has statutory access to all state and local records and has subpoena power to compel testimony or the production of documents.

As an integral part of the Legislature, PEER provides a variety of services, including program evaluations, economy and efficiency reviews, financial audits, limited scope evaluations, fiscal notes, special investigations, briefings to individual legislators, testimony, and other governmental research and assistance. The Committee identifies inefficiency or ineffectiveness or a failure to accomplish legislative objectives, and makes recommendations for redefinition, redirection, redistribution and/or restructuring of Mississippi government. As directed by and subject to the prior approval of the PEER Committee, the Committee's professional staff executes audit and evaluation projects obtaining information and developing options for consideration by the Committee. The PEER Committee releases reports to the Legislature, Governor, Lieutenant Governor, and agency examined.

The Committee assigns top priority to written requests from individual legislators and legislative committees. The Committee also considers PEER staff proposals and written requests from state officials and others.

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June 20, 1989

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Joint Committee on Performance Evaluation and Expenditure Review

PEER Committee



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June 20, 1989

Honorable Ray Mabus, Governor
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At its meeting of June 20, 1989, the PEER Committee authorized release of its report entitled A Review of Audit Fee Adjustments and Charge-offs by the Office of State Auditor July 1, 1984, Through December 31, 1988.


REPRESENTATIVE J. P. COMPRETTE, CHAIRMAN

This report does not recommend
increased funding or additional staff.

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**A REVIEW OF AUDIT FEE ADJUSTMENTS AND CHARGE-OFFS
BY THE OFFICE OF THE STATE AUDITOR
JULY 1, 1984, THROUGH DECEMBER 31, 1988**

EXECUTIVE SUMMARY

Background

MISS. CODE ANN. Section 7-7-201 et. seq. authorizes the Office of the State Auditor (Department of Audit) to audit the financial affairs of state and county governmental departments, public school districts, junior college districts and any other agencies which share revenues derived from taxes or fees imposed by the Legislature and other public bodies supported in part or wholly from public funds.

The Department of Audit also has the authority to charge fees for audit services provided to the entities mentioned above. Prior to October 1, 1984, state law required the Department of Audit to charge \$25 per day for each auditor engaged in performing audits of local government entities and \$100 per day for each auditor performing audits of state agencies. The Legislature increased the daily rate to \$100 per day for local government entities in 1984. The current rate remains at \$100 per day for each auditor except in cases where federal funds are being audited. In these cases, the statutes authorize the Department of Audit to charge governmental entities the actual audit cost that exceeds \$100 per day for that portion of audit cost related to federal audit requirements. The Department of Audit's authority to charge actual cost in excess of \$100 per day is completely discretionary. The minimum \$100 per day rate is mandatory in all cases.

Audit Fee Adjustments

The Department of Audit made total billing adjustments of \$68,992.45 from July 1, 1984, through December 31, 1988. The department made adjustments to correct billing errors such

as incorrect coding of time sheets or keypunch errors during the processing of time sheets. The adjustment process did not require the use of management judgement since adjustments were merely error corrections, and errors were corrected as detected.

Audit Fee Charge-offs

The Department of Audit made audit fee charge-offs of \$73,614.89 from July 1, 1984, through December 31, 1988. Charge-offs represent actual reductions in billing amounts for reasons other than error correction. PEER determined that although the level of charge-offs is relatively small (compared to \$13,011,772.54 in audit fee collections) weaknesses do exist within the department's system for determining audit fee charge-offs, and the weaknesses have resulted in consistency and compliance problems.

The Department of Audit made audit fee charge-offs totaling \$73,614.89 without written policies, procedures, and criteria to govern the billing of audit fees from July 1, 1984, through December 31, 1988.

Internal control standards and accepted management standards dictate the use of written policies. While many of the charge-offs appear justifiable, the lack of written policies makes it difficult to determine the necessity and justification of each charge-off. The lack of written criteria for charge-offs jeopardizes the consistency of charge-offs among all entities audited during the period 1985 through 1988. For example, school districts received over 46% of the charge-offs during this period while counties received less than 1%.

The Department of Audit did not charge governmental entities \$28,952.52 for audit services as required by MISS. CODE ANN. Section 7-7-211 et. seq. during the period July 1, 1984, through December 31, 1988.

As stated above, the Department of Audit made audit fee charge-offs totaling \$73,614.89 from July 1, 1984, through December 31, 1988. Of this amount, \$28,952.52 represents charge-offs made without statutory authority. Audit fees were reduced below the statutory rate of \$100 per day per auditor for seventy-eight entities on eighty-eight occasions. PEER compared the statutory minimum billable amount to the amount actually billed and collected. School districts were again the primary beneficiaries, receiving \$20,074.06 (over 69%) of the total \$28,952.52.

The Department of Audit does not formally notify auditees of estimated audit fees during the planning and engagement phase of audits.

Generally accepted auditing standards (GAAS) require that audits be adequately planned. The public accounting profession, including the Department of Audit, commonly uses engagement letters as a planning tool to document the understanding between the auditor and the auditee regarding the nature and terms of a forthcoming audit. According to the Miller Comprehensive GAAS Guide (1989 edition), certain issues should be agreed upon in an engagement letter, including an estimate of the fee to be charged for the engagement. The lack of a fee estimate gives the auditee almost no opportunity to predict the actual fee or any significant opportunity to protest, once the fee has been billed.

Recommendations

1. The Department of Audit should develop written policies and procedures to govern the billing process, including adjustments and charge-offs. In addition, the Department of Audit should establish uniform criteria for charge-offs to insure that all auditees are billed consistently.
2. The Department of Audit should seek collection of audit fees that were not collected as required by statute from July 1, 1984, through December 31, 1988. The funds should be deposited to the state general fund as collected.
3. The Department of Audit should modify its planning and engagement procedures for audit engagements to include calculations of estimated audit fees for each engagement.
4. In addition to the use of estimated fees, PEER recommends that the Department of Audit provide staff assistance to state and local government entities during the annual budget process to develop estimates of audit fees. Such estimates should not obligate the Department of Audit in any manner but only serve as a form of assistance to auditee entities.
5. If Department of Audit officials feel that the current statutory billing requirements are inequitable, they should develop recommendations to the Legislature, based on their knowledge and experience in auditing other governmental entities, that would provide for a more equitable billing process.

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A REVIEW OF AUDIT FEE ADJUSTMENTS AND CHARGE-OFFS
BY THE OFFICE OF THE STATE AUDITOR
JULY 1, 1984, THROUGH DECEMBER 31, 1988

INTRODUCTION

Authority

At its meeting on January 17, 1989, the PEER Committee authorized a review of fee adjustments and charge-offs by the Office of the State Auditor (Department of Audit) during the period July 1, 1984, through December 31, 1988. The Committee acted in accordance with MISS. CODE ANN. Section 5-3-57 (1972).

Purpose and Scope

PEER's review had three purposes:

1. To determine the nature and amount of audit fee adjustments and charge-offs by the Department of Audit during the period July 1, 1984, through December 31, 1988;
2. To determine if the Department of Audit made audit fee charge-offs in accordance with Mississippi statutes; and,
3. To determine if the Department of Audit made audit fee adjustments and charge-offs in accordance with its own audit policies and procedures.

Methodology

In conducting this review, PEER:

1. Reviewed relevant state statutes for the period 1984 through 1988;
2. Reviewed Department of Audit policies and procedures manuals;
3. Interviewed former and current officials of the Department of Audit; and,
4. Analyzed Department of Audit data related to billings for audit services during the period 1984 through 1988.

Overview

The purpose of this review was to determine the nature and amount of audit fee adjustments and charge-offs by the Department of Audit during the period July 1, 1984, through December 31, 1988, and whether such adjustments and charge-offs were made in accordance with state statutes and established policies and procedures.

PEER determined that the Department of Audit made audit fee adjustments (billing error corrections) of \$68,992.45 and charge-offs (reductions of actual fees billed) of \$73,614.89 during this period. The Department of Audit does not have written policies and procedures to insure that adjustments and charge-offs are justifiable and properly authorized, and has not established formal criteria to insure that audit fee charge-offs are handled consistently for all auditee entities.

PEER determined that the Department of Audit made charge-offs of \$28,952.52 of the total charge-offs of \$73,614.89 without statutory authority. The Department of Audit failed to charge at least the statutory minimum rate of \$100 per day for the services of each staff auditor assigned to various engagements.

PEER determined that the Department of Audit does not provide governmental entities with estimates of audit fees for their respective audit engagements during the planning and engagement phase of the engagements. As a result, auditees must depend on the efficiency of the Department of Audit's auditors and have no basis by which to measure their performance.

BACKGROUND

Statutory Authority

The Department of Audit derives its authority to perform governmental audits from MISS. CODE ANN. Section 7-7-201 et. seq. Its specific duties include the authority: to audit and when necessary investigate the financial affairs of the departments, institutions, boards, commissions or other agencies of state government, as part of the publication of a comprehensive annual financial report for the State of Mississippi; and to audit and when necessary investigate the offices, boards and commissions of county governments, public school districts, junior college districts, and any other local offices or agencies which share revenues derived from taxes or fees imposed by the Legislature, and all other public bodies supported by funds derived in part or wholly from public funds, except municipalities.

The Department of Audit also has authority to charge fees for audit services provided to the entities mentioned above. This authority is derived from MISS. CODE ANN. Section 7-7-211 for audit services provided to local government entities (counties, school districts, etc.) and MISS. CODE ANN. Section 7-7-213 for audit services provided to state agencies. Currently, the statutes require the Department of Audit to charge \$100 per day for the services of each auditor engaged in performing an audit or other service for a local government entity or state agency. The State Auditor also has the authority under MISS. CODE ANN. Section 7-7-211 (k) to contract with qualified public accounting firms to perform selected audits of governmental entities. However, the statute does not set a minimum or maximum billable rate for these services.

Prior to October 1, 1984, state law required the Department of Audit to charge \$25 per day for each auditor engaged in performing audits of local government entities and \$100 per day for each auditor performing audits of state agencies. Senate Bill 2655 (codified as an amendment to MISS. CODE ANN. Section 7-7-211), passed by the 1984 Mississippi Legislature, increased the rate to \$100 per day for local government entities, making it consistent with the state agency rate. Initially the increase was only to be effective until October 1, 1985; however, Senate Bill 2718, passed by the 1985 Mississippi Legislature, removed the repeal date and made the \$100 per day rate permanent for local government entities.

In response to Congress' Single Audit Act of 1984, which increased the audit requirements for all governmental entities receiving federal funds, the 1986 Mississippi Legislature passed House Bill 740 (codified as MISS. CODE ANN. Section 7-7-214). This legislation authorizes the Department of Audit to charge governmental entities the actual audit cost that exceeds \$100 per day for each auditor when such entities might receive reimbursement from the federal government for that portion of the audit cost related to federal audit requirements. The Department of Audit has developed a cost allocation plan and uses this plan to determine annually a billing rate for the audit of entities' federal funds. The rate is applied based on the fiscal year being audited. The initial rate for 1985 was \$209.68 per day, which has since increased to \$295.04 for 1988. The Department of Audit's authority to charge actual cost in excess of \$100 per day is completely discretionary. Thus, only the minimum \$100 per day rate is mandatory.

Billing of Audit Fees

On December 8, 1983, PEER released A Management and Operational Review of the Mississippi State Department of Audit. The report stated that the system for billing, collecting and depositing audit fees was insufficient and denied the state full use of local and non-state funds. The report stated that the Department of Audit had no written policies and guidelines regarding billing and collection of audit fees, resulting in a failure to perform these functions on a timely basis. The report also stated that the \$25 per auditor per day billing rate for local government entities was insufficient, resulting in a burden on the state general fund for local government audit costs.

As stated earlier, the 1984 Mississippi Legislature amended the statutes to require the Department of Audit to begin charging \$100 per day for each auditor on audits of local government entities as of October 1, 1984. In addition, the Department of Audit automated its time reporting system for staff, began generating quarterly invoices, and instituted a tracking system to identify entities that were not making timely payments. Under this system, staff members prepare time sheets that reflect the amount of time worked on the various audit engagements. Audit managers review time sheets and send them to the administrative division for processing. The administrative division enters the time sheet information into

the automated system, which processes and produces quarterly billings for auditees. Division directors review the billings for their respective divisions prior to mailing.

Nature and Amount of Adjustments and Charge-offs

The 1984 increase in the statutory rate from \$25 to \$100 per day and the additional audit costs associated with the Single Audit Act of 1984 had a significant impact on local government entities in Mississippi, particularly counties and school districts. Audit fees increased dramatically and billings from the State Auditor's office became more frequent. Local government entities became more conscious of audit costs and the amount of time auditors spent on audits. The State Auditor's office also became more conscious of audit fee billings and collections with its new billing system. This additional emphasis on audit billing by the Department of Audit and its auditees resulted in a related increase in adjustments and charge-offs.

The Department of Audit made total billing adjustments of \$68,992.45 from July 1, 1984, through December 31, 1988 (see Exhibit 1, page 5). The department made adjustments to correct billing errors such as incorrect coding of time sheets or keypunch errors during the processing of time sheets. The adjustment process did not require the use of management judgement since adjustments were merely error corrections, and errors were corrected as detected. As reflected in Exhibit 1, the total of audit fee adjustments represents less than 1% of the total audit fee collections (\$13,011,772.54) during the same period.

The Department of Audit made charge-offs of \$73,614.89 from July 1, 1984, through December 31, 1988 (see Exhibit 1, page 5). Charge-offs represent reductions in actual billing amounts for reasons other than error correction. According to former and current Department of Audit officials, the department made charge-offs for a variety of reasons including: auditees requested fee reductions because they had not budgeted sufficiently for audit costs; auditors incurred excess audit time because of on-the-job training of new staff auditors; the department decided to remove small billing amounts from the books that were not considered feasible to collect; and those auditees who were partially federally funded lacked funding for the federal portion of audit fees. Exhibit 1 also reflects that the total of audit fee charge-offs represents less than 1% of total fee collections during the same period.

PEER recognizes that a majority (62.5%) of the individual charge-offs during this period were less than \$100 each; however, these small charge-offs represent only 2.13% of the total value of all charge-offs from July 1, 1984, through December 31, 1988 (see Exhibit 2, page 6). As a result, individual charge-offs in excess of \$100 each account for \$72,045.35 of the total \$73,614.89 in charge-offs.

Exhibit 1

Office of the State Auditor Comparison of Audit Fee Adjustments, Charge-offs and Collections by Fiscal Year

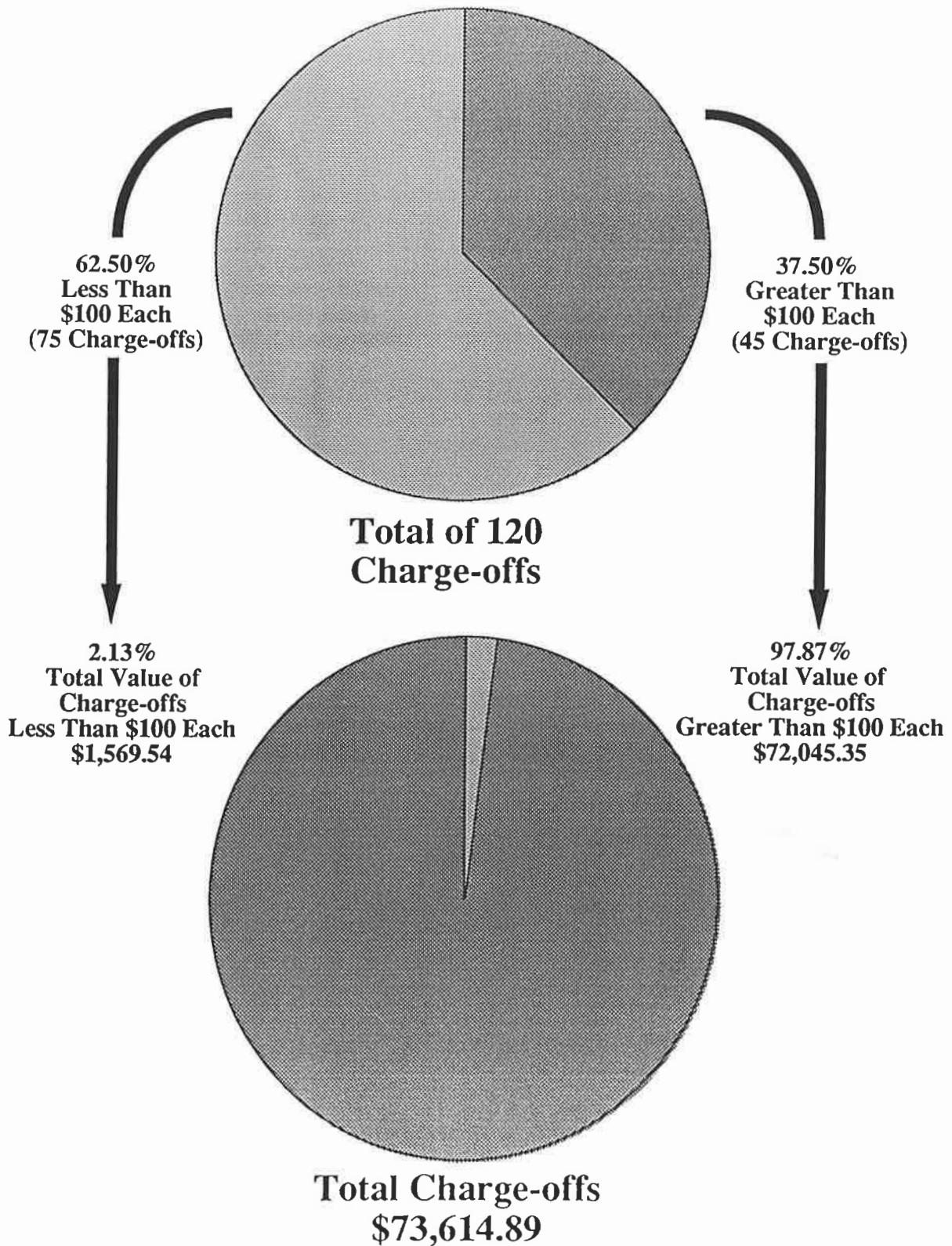
<u>Fiscal Year</u>	<u>Audit Fee Adjustments</u>	<u>Audit Fee Charge-offs</u>	<u>Audit Fee Collections</u>
1985	\$7,662.50	\$63.02	\$2,551,111.00
1986	925.00	8,534.70	3,123,591.00
1987	52,490.55	38,508.65	2,455,293.00
1988	6,953.87	21,981.29	3,377,465.00
1989*	<u>960.53</u>	<u>4,527.23</u>	<u>1,504,312.54</u>
	<u>\$68,992.45</u>	<u>\$73,614.89</u>	<u>\$13,011,772.54</u>

*NOTE: This data represents the six months ended December 31, 1988.

SOURCE: PEER analysis of Department of Audit records and Legislative Budget Committee reports.

Exhibit 2

Office of the State Auditor
Comparison of the Number of Charge-offs
Above and Below \$100 Each



SOURCE: PEER analysis of Office of the State Auditor records

FINDINGS

PEER's review focused on the Department of Audit's billing system in general and the policies and procedures for audit fee charge-offs in particular. PEER determined that although the level of adjustments and charge-offs is relatively small for this period, weaknesses do exist within the system for determining audit fee charge-offs, and the weaknesses have resulted in consistency and compliance problems.

The Department of Audit made audit fee charge-offs totaling \$73,614.89 without written policies, procedures, and criteria to govern the billing of audit fees from July 1, 1984, through December 31, 1988.

According to billing records at the Department of Audit, the department reduced audit fees for ninety-five entities (agencies, school districts, counties and colleges/universities) on 120 occasions from July 1, 1984, through December 31, 1988 (see Appendix A, page 13). According to interviews with former and current audit officials, charge-offs were based solely on management judgement. The Department of Audit has never had written guidelines regarding the reduction of audit fees.

Internal control standards and accepted management standards dictate the use of written policies. Written policies promote consistency in application and more clearly communicate intentions and desires, thus reducing the level of judgement necessary to make decisions. Written policies and procedures also provide a means of documentation to support the actions of management. While many of the audit fee charge-offs appear justifiable, the lack of written policies and procedures makes it difficult to determine the necessity and justification of each charge-off. No departmental policy exists giving any official the authority to request and approve charge-offs. The lack of written criteria for charge-offs jeopardizes the consistency of charge-offs among all entities audited during the period 1985 through 1988. School districts received over 46% of the total charge-offs during this period while counties received less than 1% (see Exhibit 3, page 9).

The Department of Audit did not charge governmental entities \$28,952.52 for audit services as required by MISS. CODE ANN. Section 7-7-211 et. seq. from July 1, 1984, through December 31, 1988.

As stated earlier, the Department of Audit made audit fee charge-offs totaling \$73,614.89 from July 1, 1984, through December 31, 1988. Of this amount, \$28,952.52 represents charge-offs made without statutory authority. Audit fees were reduced below the statutory rate of \$100 per day per auditor for seventy-eight entities on eighty-eight occasions during the period 1985 through 1988 (see Appendix A, page 13). PEER analyzed the billings by applying the statutory rate (\$100 per day) to the number of hours of staff time recorded for each engagement. The statutory minimum billable amount was compared to the amount actually billed and collected. The charge-off amounts range from \$.02 to \$4,712.50.

Two sections of the MISSISSIPPI CODE establish the minimum billing rates for audit and other services provided by the Department of Audit. In relation to the cost of audits for counties, school districts and other local government entities, MISS. CODE ANN. Section 7-7-211 states:

Such part shall be paid by the state from appropriations made by the Legislature for the operation of the State Department of Audit as may exceed the sum of One Hundred Dollars (\$100) per day for the services of each staff person engaged in performing the audit or other service, which sum shall be paid by the county, district, department, institution or other agency audited out of its general fund or any other available funds from which such payment is not prohibited by law.

For the costs of audits for state agencies, MISS. CODE ANN. Section 7- 7-213 states, "[T]he amounts to be charged for performing audits and other services shall be the actual cost, not to exceed One Hundred Dollars (\$100) per man day." PEER reported in 1988 (An Analysis of the Cost of Governmental Audits in Mississippi) that the actual cost of audits by the Department of Audit is \$24.03 per hour (\$192.24 per day) which exceeds the statutory minimum rate (\$100 per man day).

School districts were the primary beneficiaries of charge-offs below the statutory minimum, receiving \$20,074.06 (over 69%) of the total \$28,952.52 (see Exhibit 4, page 10). As a result, the state general fund absorbed a portion of the audit costs for school districts that state statutes require to be paid by the school districts. In addition, the state general fund also absorbed a portion of the audit cost of counties, colleges/universities, and state and local agencies that were supported by special funds.

The Department of Audit does not formally notify auditees of estimated audit fees during the planning and engagement phase of audits.

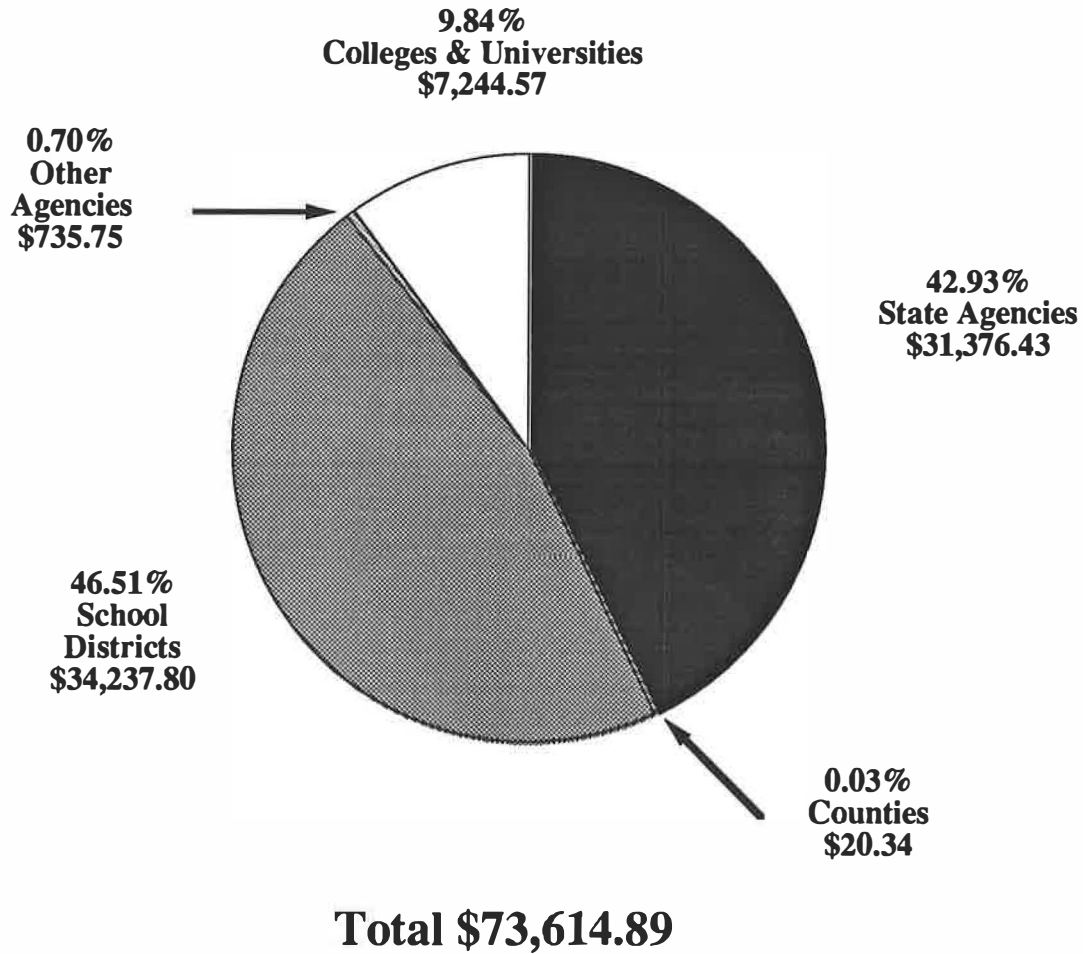
The Department of Audit has developed individual audit manuals for each audit division (county, school district, state agency, and college/university). These manuals document the policies and procedures necessary for the performance of annual financial and compliance audits in accordance with generally accepted auditing standards (GAAS). The audit manuals are well documented with planning procedures to ensure compliance with GAAS; however, the manuals do not require the department to formally communicate estimates of fees to auditees for each engagement. The school district and college/university divisions formally communicate the statutory billing rates with an engagement letter but make no reference to total estimated fees, while the county and agency divisions do not make references to rates or fees in their standard engagement letters.

Generally accepted auditing standards require that audits be adequately planned. The public accounting profession commonly uses engagement letters as a planning tool to document the understanding between an auditor and auditee regarding the nature and terms of a forthcoming audit. According to the Miller Comprehensive GAAS Guide (1989 edition), certain issues should be agreed upon in an engagement letter, including an estimate of the fee to be charged for the engagement. It should also be noted that the Department of Audit required public accounting firms to include fee estimates in engagement letters for contract audit services during the period 1985 through 1988.

According to the Miller Comprehensive GAAS Guide, the lack of a fee estimate gives the auditee almost no opportunity to predict the actual fee or any significant opportunity to protest, once the fee has been billed. In effect, entities audited by the Department of Audit, particularly those with federal funds, are parties to open-ended contracts for audit services without any control over the efficiency of the auditors assigned to their engagement.

Exhibit 3

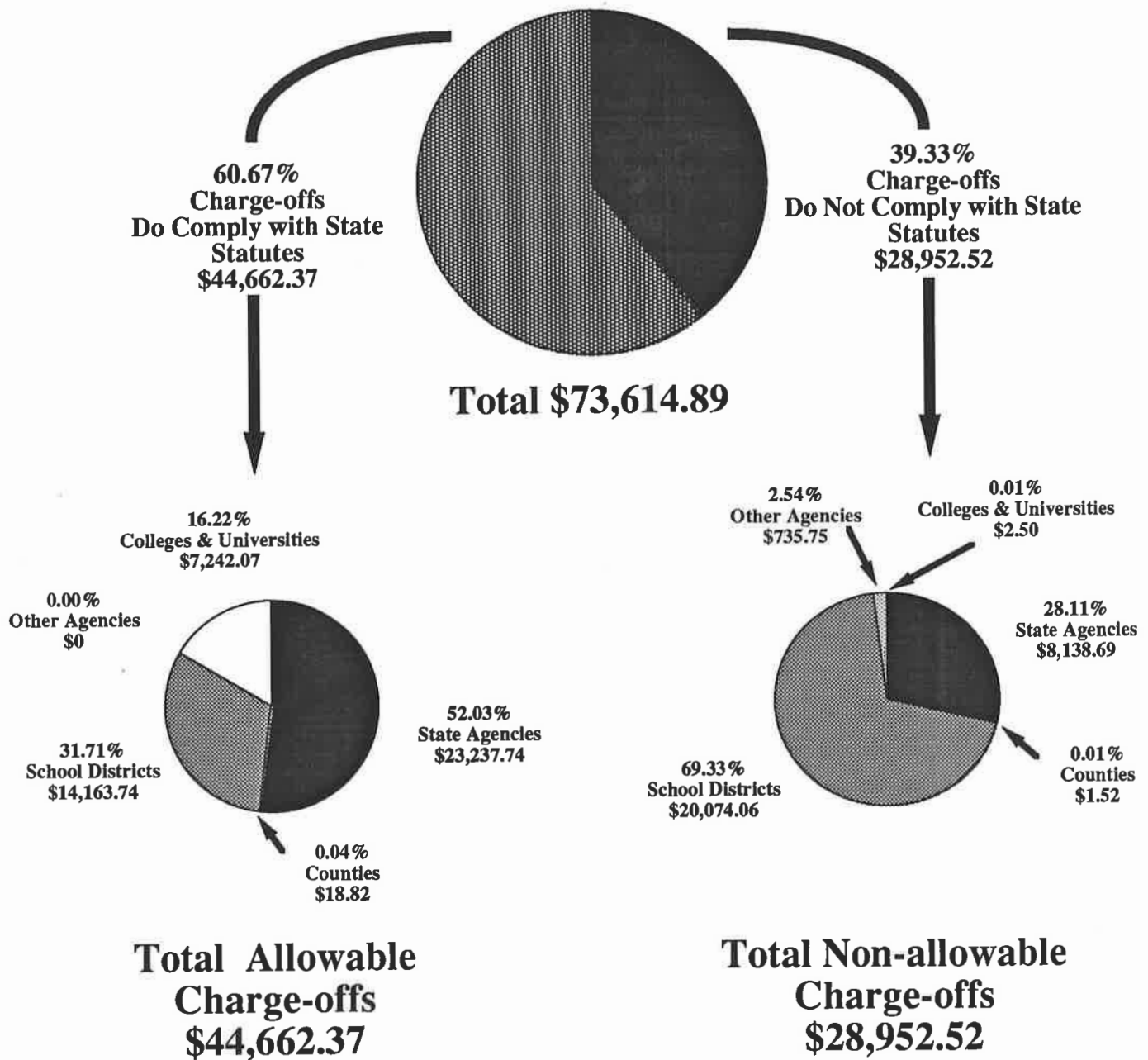
Office of the State Auditor Analysis of Charge-offs July 1, 1984, through December 31, 1988



SOURCE: PEER analysis of Office of the State Auditor records

Exhibit 4

Office of the State Auditor Analysis of Allowable vs. Non-allowable Charge-offs July 1, 1984, through December 31, 1988



SOURCE: PEER analysis of Office of the State Auditor records

RECOMMENDATIONS

1. The Department of Audit should develop written policies and procedures to govern the billing process, including adjustments and charge-offs. These policies and procedures should establish lines of authority within the Department of Audit and establish a formal authorization process for adjustments and charge-offs. In addition, the Department of Audit should establish uniform criteria for charge-offs to insure that all auditees are billed consistently. Such guidelines would provide written documentation and justification to support management actions with regard to the reduction of audit fees in the future. It should be noted, however, that the Mississippi statutes will continue to represent the primary standard that precludes the reduction of any audit fee below the statutory rate (\$100 per man day) regardless of the circumstances.
2. The Department of Audit should review time records supporting audit fees not collected. In no case should an entity be charged for a full work day (eight hours) if the auditor assigned did not work a full eight-hour day. If billings are accurate, the department should collect and deposit proceeds into the state general fund. Although many of the uncollected amounts are very small, the statutes very clearly state that these fees are to be paid by the audited entities. These amounts could easily be added to current billings for the affected entities. PEER recognizes that collection will not be possible for those entities that are no longer funded. For agencies funded both by general funds and special funds, the charge-offs should be prorated according to the funding ratio of special funds and general funds for each agency as a whole. PEER has compiled a list of uncollected fee amounts and names of the related entities for use by the Department of Audit to initiate collection (see Appendix A, page 13). The Department of Audit should notify the affected entities in advance and provide an explanation that state statutes require that these fees be collected by the Department of Audit.
3. The Department of Audit should modify its planning and engagement procedures for audit engagements to include calculations of estimated audit fees for each engagement. The department should include such estimates in engagement letters along with statements that the statutes require a minimum billing rate of \$100 per day for each auditor and that the estimates are subject to change in the event of unforeseen circumstances. Such estimates may encourage auditees to be more cooperative and offer additional assistance to auditors in an attempt to keep audit fees as low as possible.
4. In addition to the use of estimated fees, PEER recommends that the Department of Audit provide staff assistance to state and local entities during the annual budget process to develop estimates of audit fees. Such estimates should not obligate the Department of Audit in any manner but only serve as a form of assistance to the auditee entities. Through continuing education, the Department of Audit's professional staff is constantly in touch with the changing trends and standards of the profession and is in a much better position to estimate audit fees than the auditee entities. Several recent changes in auditing standards promulgated by both the American Institute of Certified Public Accountants and the United States General Accounting Office are expected to have a significant impact on the amount of time auditors spend on engagements.
5. During this review, former and current audit department officials stated that it did not seem appropriate to charge entities such as school districts for excess audit time related to on-the-job training of the Department of Audit's staff auditors. However, state statutes do not provide for such adjustments of fees. The statutory rate (\$100 per day) remains considerably less than the

department's cost (\$192.24 per day) and the cost of audits by private firms (\$196.56 per day) according to PEER's 1988 report, An Analysis of the Cost of Governmental Audits in Mississippi. If Department of Audit officials feel that the statutory billing requirements are inequitable, they should develop recommendations to the Legislature, based on their knowledge and experience in auditing other governmental entities, that would provide for a more equitable billing process.

APPENDIX A

OFFICE OF THE STATE AUDITOR
 SCHEDULE OF AUDIT FEE CHARGE-OFFS
 JULY 1, 1984 THROUGH DECEMBER 31, 1988

GOVERNMENTAL ENTITY	DATE OF CHARGE- OFF	TOTAL CHARGE- OFF AMOUNT	AMOUNT NOT IN COMPLIANCE WITH STATUTES
State Agencies			
Accountancy, Board of	9-30-87	\$0.13	\$0.13
Aeronautics Commission	9-30-87	\$4.29	\$3.75
Agricultural Aviation Board	9-30-87	\$0.13	\$0.13
Agriculture & Commerce, Dept. of	5-31-87	\$488.91	
Animal Health, Board of	6-30-87	\$93.87	\$50.00
Architecture, Board of	9-30-87	\$0.13	\$0.13
Athletic Commission	9-30-87	\$0.13	\$0.13
Attorney General	6-30-87	\$26.21	\$12.50
Audit, Department of	9-30-87	\$94.50	\$94.50
Audit, Department of	1-31-87	\$25.00	\$25.00
Auth. for Educ. Television	9-30-87	\$133.74	\$133.38
Bar Admissions, Board of	9-30-87	\$0.13	\$0.13
Chiropractic Exam., Board of	9-30-87	\$0.13	\$0.13
Cosmetology, Board of	9-30-87	\$0.25	\$0.25
Dental Examiners, Board of	9-30-87	\$0.13	\$0.13
Eleemosynary Board	9-30-87	\$1.88	\$1.88
Ellisville State School	8-31-85	\$2.00	
Emergency Management Agency	6-30-87	\$2,262.15	
Emergency Management Agency	8-30-85	\$0.50	\$0.50
Ethics Commission	9-30-87	\$0.13	\$0.13
Fiscal Management Board	5-31-87	\$575.82	
Foresters, Board of Reg. for	9-30-87	\$0.13	\$0.13
Forestry Commission	6-30-87	\$38.87	\$19.56
Funeral Services, Board of	9-30-87	\$0.13	\$0.13
Gov. Office of Fed-State Progs.	1-30-87	\$12,430.72	
Governor's Off. - Gen. Services	6-30-87	\$62.50	\$62.50
Governor's Off. - Gen. Services	6-30-87	\$37.50	\$37.50
Governor's Office	11-30-86	\$50.00	\$50.00
Governor's Office - Adm. Serv.	12-31-86	\$62.50	\$62.50
Grand Gulf Monument	3-31-87	\$339.92	\$312.50
Health Care Commission	3-31-87	\$1,773.01	\$875.00
Health Care Commission	10-31-86	\$250.00	\$250.00
Health Care Commission	6-30-87	\$102.10	\$50.00

SOURCE: PEER analysis of Department of Audit records.

GOVERNMENTAL ENTITY	DATE OF CHARGE-OFF	TOTAL CHARGE-OFF AMOUNT	AMOUNT NOT IN COMPLIANCE WITH STATUTES
Health, State Board of	6-30-87	\$3,600.45	
Highway Department	6-30-87	\$122.82	
Housing Finance Corporation	9-30-87	\$4,712.50	\$4,712.50
Housing Finance Corporation	10-31-87	\$562.50	\$562.50
Insurance Department	9-30-87	\$6.38	\$6.38
Judicial Performance Commission	9-30-87	\$0.13	\$0.13
Kuhn Memorial Hospital	6-30-87	\$102.42	\$75.00
Legislative Operations - House	3-31-87	\$12.50	\$12.50
Library Commission	6-30-87	\$95.24	\$50.00
Matty Hersee Hospital	6-30-87	\$78.95	\$62.50
Matty Hersee Hospital	4-30-87	\$6.86	
Medicaid Division	6-30-87	\$328.39	
Medical Licensure, Board of	9-30-87	\$6.75	\$6.75
Mental Health, Dept. of	6-30-87	\$97.99	\$50.00
Military Department	6-30-87	\$143.17	\$75.00
Military Department	4-30-87	\$91.86	
Military Department	4-30-86	\$53.47	
Mississippi State Senate	3-31-84	\$62.50	\$62.50
Motor Vehicle Commission	9-30-87	\$0.13	\$0.13
Natural Resources, Dept. of	6-30-87	\$139.60	
Nursing, Board of	9-30-87	\$0.13	\$0.13
Optometry, Board of	9-30-87	\$0.13	\$0.13
Pat Harrison Waterway District	9-30-87	\$2.00	\$2.00
Pearl River Basin Dev. District	9-30-87	\$2.75	\$2.75
Pharmacy, Board of	9-30-87	\$0.13	\$0.13
Physical Therapy, Board of	9-30-87	\$0.13	\$0.13
Polygraph Examiners, Board of	9-30-87	\$0.13	\$0.13
Public Accounts, Dept. of	10-31-86	\$62.50	\$62.50
Public Contractors, Board of	9-30-87	\$0.13	\$0.13
Public Emp. Retirement System	9-30-87	\$58.38	\$58.38
Public Service Commission	6-30-87	\$63.87	\$62.50
Real Estate Commission	9-30-87	\$0.13	\$0.13
School for the Blind	5-31-87	\$629.29	
School for the Blind	6-30-87	\$66.29	\$32.12
School for the Blind	5-31-86	\$5.48	
School for the Blind	12-31-87	\$1.08	
School for the Blind	5-31-87	\$5.48	
School for the Deaf	5-31-87	\$1,096.80	
School for the Deaf	6-30-87	\$13.87	\$12.50
Secretary of State	8-31-85	\$0.50	\$0.50
Soil & Water Conservation Comm.	9-30-87	\$8.88	\$8.88
State Aid Road Division	9-30-87	\$159.31	\$75.00
State Aid Road Division	12-31-85	\$0.50	
Supreme Court Clerk	9-30-87	\$1.25	\$1.25
Tombigbee Waterway Mgmt. Dist.	9-30-87	\$1.13	\$1.13

GOVERNMENTAL ENTITY	DATE OF CHARGE-OFF	TOTAL CHARGE-OFF AMOUNT	AMOUNT NOT IN COMPLIANCE WITH STATUTES
Treasurer's Office	5-31-87	\$13.71	
Veterinary Examiners, Board of	9-30-87	\$0.13	\$0.13
Vocational Rehab. for the Blind	9-30-87	\$1.04	\$0.50
Yellow Creek Inland Port Auth.	9-30-87	\$6.75	\$6.75
Yellow Creek Watershed Authority	10-31-86	\$87.50	\$87.50
Youth Services, Dept. of	9-30-87	\$4.88	\$4.88
Total - State Agencies		\$31,376.43	\$8,138.69

Counties

Alcorn County	9-30-87	\$1.00	
Calhoun County	12-31-84	\$0.02	\$0.02
Carroll County	5-31-87	\$17.82	
Marshall County	3-31-86	\$0.50	\$0.50
Montgomery County	3-31-87	\$0.50	\$0.50
Perry County	3-31-85	\$0.50	\$0.50
Total - Counties		\$20.34	\$1.52

School Districts

Carroll County Schools	4-30-87	\$2,527.64	
Clay County Schools	6-30-87	\$1,752.60	\$805.24
Covington County Schools	11-30-87	\$3,277.98	\$2,464.15
Covington County Schools	9-30-87	\$1,717.67	\$893.70
Greene County Schools	1-31-86	\$4,693.75	\$4,693.75
Greenville Municipal Schools	11-30-86	\$465.97	\$412.50
Greenwood Municipal Schools	11-30-87	\$5,093.31	\$3,491.85
Greenwood Municipal Schools	9-30-87	\$2,378.22	\$87.28
Harrison County Schools	9-30-88	\$2,064.11	
Holmes County Schools	11-30-85	\$0.50	\$0.50
Marion County Schools	9-30-85	\$1,000.00	\$1,000.00
Marshall County Schools	9-30-88	\$2,463.12	\$912.93
Quitman County Schools	9-30-87	\$3,192.19	\$2,604.03
Stone County Schools	6-30-86	\$2,262.50	\$2,262.50
Webster County Schools	4-30-87	\$501.87	
Webster County Schools	2-28-87	\$330.41	
Webster County Schools	11-30-86	\$35.65	
Winona Municipal Schools	11-30-87	\$324.83	\$295.63
Winona Municipal Schools	11-30-86	\$155.48	\$150.00
Total - School Districts		\$34,237.80	\$20,074.06

GOVERNMENTAL ENTITY	DATE OF CHARGE- OFF	TOTAL CHARGE- OFF AMOUNT	AMOUNT NOT IN COMPLIANCE WITH STATUTES
<u>Colleges and Universities</u>			
Delta State University	5-31-87	\$1,553.30	
Jones Junior College	4-30-87	\$1,419.47	
Jones Junior College	11-30-86	\$87.74	
MSU - Coop. Extension Service	9-30-85	\$0.50	\$0.50
Miss. Gulf Coast Junior College	4-30-87	\$1,901.58	
Miss. Gulf Coast Junior College	4-30-87	\$1,231.16	
Miss. Gulf Coast Junior College	4-30-87	\$1,048.82	
University of Mississippi	8-31-85	\$2.00	\$2.00
		<u>-----</u>	<u>-----</u>
Total - Colleges/Universities		\$7,244.57	\$2.50
		<u>-----</u>	<u>-----</u>
<u>Other Governmental Entities</u>			
Amite-Wilkinson Industrial Muni.	9-30-85	\$150.00	\$150.00
Hospital Equipment Authority	9-30-87	\$223.25	\$223.25
Jackson Redevelopment Authority	3-31-86	\$362.50	\$362.50
		<u>-----</u>	<u>-----</u>
Total - Other Governmental Entities		\$735.75	\$735.75
		<u>-----</u>	<u>-----</u>
TOTAL CHARGE-OFFS		\$73,614.89	\$28,952.52
		<u>=====</u>	<u>=====</u>



State of Mississippi

PETE JOHNSON
AUDITOR

June 19, 1989



Mr. John W. Turcotte
Executive Director
PEER Committee
Central High Legislative Services Building
Post Office Box 1204
Jackson, Mississippi 39215-1204

Dear Mr. Turcotte:

This office has reviewed the findings and recommendations of your report. "A Review of Audit Fee Adjustments and Charge-Offs by the Office of the State Auditor, July 1, 1984, to December 31, 1988."

Since taking office in January 1988, I have aggressively sought to collect all audit fees in accordance with statutory requirements. Upon taking office in January 1988, forty six (46) uncollected audit bills were on hand totaling \$113,185.16 and today we have one (1) uncollected audit bill of \$30.26, which was billed in April 1989. Two (2) audit bills totaling \$6,022.01 are pending collection at this time awaiting an attorney general's opinion on the billings.

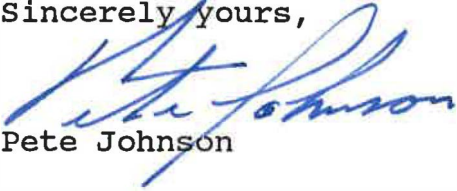
Since January 1988, this office has collected the \$113,185.16 which was on hand and owing at that time and has billed and collected \$8,075,530.89. Written policies and procedures are now in place in accordance with statutory requirements to ensure proper billing and collection of all audit fees. This office has requested the counsel of the Attorney General's Office in seeking collection of audit fees that were not collected as per Appendix A of this report as well as any interest that may be due.

The Auditor's Office engagement procedures will include calculations of estimated fees for each engagement. While this information has been available and utilized in-house, for audit planning and budgeting these estimates have not been disseminated to governmental entities, except upon request. This situation will be corrected on all future Auditor's Office audit engagements. We will also work with state and local government entities during the annual budget process in developing estimates of audit fees.

Mr. John Turcotte
June 19, 1989
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I would like to express my appreciation to Danny Miller, CPA of your staff for the thorough and professional manner in which this review was performed. It is through diligent efforts like this that government can truly improve and be carried on in the best interests of Mississippi taxpayers.

Sincerely yours,

A handwritten signature in blue ink that reads "Pete Johnson". The signature is stylized with a large initial "P" and a long, sweeping underline.

Pete Johnson

PJ:lah

June 19, 1989



Mr. John W. Turcotte
Legislative PEER Committee
P. O. Box 1204
Jackson, MS 39215-1204

Dear Mr. Turcotte:

This is the response to A Review of Audit Fee Adjustments and Charge-offs by the Office of the State Auditor from July 1, 1984 to December 31, 1988. This response covers only the period from January 1984 through December 1987.

We believe all audit fees during this period were charged-off in a way that complied with state law and that was consistent. The draft report did not document any inconsistency in the application of charge-off policies. In addition, it did not explore the reasons for the charge-offs. The reasons are within an appropriate and reasonable application of the statute.

During this period, a number of improvements were made associated with audit fees, including the development of a computerized time-recording system, a quarterly billing process, and the use of audit engagement letters. The policies for charging-off an audit fee were well known. No charge-off was made unless recommended by an audit division director, approved by the Department of Audit director, and then approved by me as deputy state auditor.

Listed below are the reasons for audit fee charge-offs. For the first three categories and the Miscellaneous category, the charge-offs represented an attempt to apply a standard of reasonableness and practicality. It makes no sense to incur an

Mr. John W. Turcotte
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expense of preparing the bill which is greater than the bill itself. For example, 21 of the charge-offs were less than the price of a postage stamp. It does not make sense to charge for audit work for which the entity does not have the funds to pay (particularly, for example, if it means taking money from school programs). And it does not make sense to charge for audit work on an agency which is no longer in existence. We believe the Legislature did not intend for the statute to be construed in a way which did not make common sense.

For the fourth category, the charge-offs represented invoices produced by our computer billing system on agencies that had separate audits conducted by private CPA firms. This was a paper transaction and did not represent billings for actual work. We made the decision that it was easier to program the system for all the state agencies and then charge-off those audited by private firms than to change programs each year depending on which entities were audited by private CPA firms.

For the fifth category, we interpreted the statutes to mean that certain training expenses were not part of the "cost" of the audit. While Sections 7-7-211(e) and 7-7-213 limit the State Auditor's office to charging no more than \$100 per day, they give the office the flexibility to determine what constitutes the "cost" of the audit work. Since certain training expenses were unrelated to the final audit, they were not part of the cost of that audit.

The following is a detailed explanation of each of the categories of charge-offs.

Bills Less Than \$25.00:

Our Division of Administrative Services determined the administrative cost to prepare, record, and mail an invoice, and the cost associated for the entity to write a check and return it to the Department of Audit. This cost was determined to be \$25.00. Entities were also reluctant to pay invoices for small amounts, and additional time and care had to be taken to send out second notices on unpaid bills. For these reasons, it was determined that any bill for less than \$25.00 would not be mailed. (40 of the 88 charge-offs, or \$63.02, fall into this category)

Entities Audited After Legislative Closure:

Entities can only be finally audited after their books have been closed for the fiscal year; therefore, audits of one fiscal year are paid with funds from the next year's appropriation. If an entity was closed or merged with another entity, it still required an audit; however, there was no entity which had funds budgeted for the audit. In these cases there was no appropriation for audit costs. All such bills had to be charged-off. (Four charge-offs at \$1,237.50)

Federal Audit Charges:

In 1986, the Department of Audit was required by federal legislation to begin auditing federal programs under the Single Audit Act. The Mississippi Legislature passed a law which enabled the Department of Audit to charge actual cost instead of just \$100.00 per day. The intent was for the amount in excess of \$100 per day to be paid from the federal sources. In many cases, the entities had not budgeted for federal audit costs or received federal funds for that purpose. The Department of Audit knew these factors could present problems for the entities. A memorandum was sent with the invoice stating that each entity should call if any problems were encountered when attempting to pay the bill. The memorandum was sent to ensure each entity would be treated consistently in the billing process. The charge-offs in this category represent federal audit work for which there were no federal funds available for reimbursement. (20 charge-offs or \$3,818.43)

CAFR Charges:

In 1986, the State Auditor's office switched from auditing individual state agencies to auditing state government as a whole, and we produced a Comprehensive Annual Financial Report (CAFR). Because of staffing constraints, we arranged for a few selected agencies to contract with private CPA firms to conduct their audits; those results were combined then with our work into the CAFR. Because of the way our computerized cost

Mr. John W. Turcotte
June 19, 1989
Page Four

CAFR Charges (continued):

allocation system worked, several of these agencies received invoices, even though they had had a full scale audit. As a result, these invoices were not sent. (Six charge-offs or \$5,690.51)

School District Charges:

The Division of School Audits experienced high staff turnover in calendar years 1986 and 1987. On several occasions, new employees had to audit school districts with little training time. This necessitated additional field and office review of their work product. This was necessary to keep the audits current. Due to this factor, audit time budgets were exceeded. Audits which had taken 240 hours in the past were taking 300 or more hours. Many of the schools had not budgeted for these higher rates. When invoices were prepared, copies were given to the School Division Director. The Director, reviewing historical costs and budgeted amounts, flagged invoices where costs were extremely high. Where costs were high, the chargeable time for the new employee was reduced to account for the training time. All invoices were reviewed in the same manner under this system. (Seven charge-offs or \$10,641.88)

Miscellaneous:

The Department of Audit did not charge itself for audit services. There was no appropriation to pay it, and it would not benefit anyone for a bill to be written, paid, and remitted. (These three charges totaled \$182.00)

Two entities on PEER's list were removed from the list of entities to be audited by the State Auditor's office and, therefore, those old bills were not entered into the accounting system. These bills for the Yellow Creek Watershed Authority and the Amite-Wilkinson Industrial Authority, totaling \$237.50, were therefore charged-off.

Mr. John W. Turcotte
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Page Five

In 1985 and 1986, the Greene County School District was facing extremely serious revenue shortfalls. In an effort to avoid bankruptcy, our staff worked closely with the school district to remedy its problems. During that time, it became apparent that the school district would not have the funds to pay our audit bill. As a result, and rather than take money from the educational program, we decided to charge-off \$4,693.75

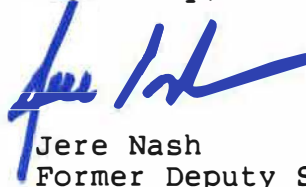
Parts of two other old bills (the Senate and the Marion County Schools) were charged-off in response to documentation provided to our office by those officials. That amounted to \$1,062.50.

Two entities, the Jackson Redevelopment Authority and the Governor's office, were partly financial audits and partly investigative audits. The \$362.50 and \$50.00, respectively, that were charged-off, represented those parts of the invoices that were not attributed to the financial statements.

As for the draft report's recommendation that the Department should modify its planning and engagement procedures to include calculations of estimated audit fees, we decided, at the time we began the practice of using formal audit engagement letters, that it was not practical to provide that information because of all the new GAAP audit procedures and single audit work which we instituted. Now that the State Auditor's office has a billing history on each entity, it may be possible to make an estimate of audit charges at the entrance conference.

Thank you for the opportunity to respond to the draft report, and please call me if I can provide more information.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jere Nash", is written over a blue horizontal line.

Jere Nash
Former Deputy State Auditor

JN:ccr