

## **Federal Funds and the Audit Law As They Relate to Quasi-Public Entities and Local Auditees' Reporting**

### **I. Introduction**

The Legislative Auditor (LLA) is charged under the constitution and statutes with the duty to audit and review the accounts and records of both public and quasi-public entities. The LLA has very broad authority under R.S. 24:513, *et seq.*, to audit various types of funds including: federal, state, local and certain private funds. The legislature provides this authority to enable the LLA to give the citizens a full accounting of how public funds are used.

Questions frequently arise during audits as to the role of federal funds under the audit law. Specifically, to what extent do federal funds determine whether an entity is subject to the audit law and what federal funds must be reported by subject entities? Federal funds may be transferred to a public or quasi-public entity through two different methods: direct appropriation or as “pass through” funds. Federal monies that are directly appropriated to an entity do not travel through an intermediary entity. In contrast, “pass through” funds travel through an intermediary on their way to the recipient entity.

In Section II this memo will examine a particular type of quasi-public entity, specifically, not-for-profit entities that receive public funds. In Section III this memo will address the impact federal funds will have on reporting requirements under the audit law. Contrasting the two types of entities will help illustrate what federal funds are used to determine whether an entity is subject to audit and what federal funds must be reported. The specific questions that will be answered are:

1. Are federal funds that are transferred through either direct appropriation or as “pass through” funds considered “assistance” in determining whether a not-for-profit entity is deemed to be a quasi-public subject to audit under R.S. 24:513A(1)(b)(iv)?
2. What is the effect of the subsequent transfer?
3. Are federal funds that are transferred through either direct appropriation or as “pass through” funds to local auditees considered “revenue and other sources” subject to the reporting requirements under R.S. 24:513J(1)(c)(i)-(iv)?

These questions address two very different issues: which not-for-profit entities are subject to audit and what types of funds determine the level of reporting required for local auditees. The first question deals with a narrow issue relating to one type of quasi-public entity. The focus in this instance is whether federal funds are used to decide if a not-for-profit organization is deemed to be a quasi-public and thus subject to audit. The second question deals with the broader issue of reporting requirements. Specifically, whether federal funds impact the reporting categories for local auditees is the central issue.

### **II. Is a Not-For-Profit Subject to Audit under R.S. 24:513A(1)(b)(iv)?**

The audit law identifies what types of entities are subject to the audit law. Included among the subject entities are quasi-public agencies or bodies. Not-for-profit and for-profit entities may qualify as a quasi-public entity through various criteria defined in R.S. 24:513A(1)(b) (i)-(v).

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Each set of criteria stands on its own; in other words, the criteria are independent of each other. Once an entity meets the criteria it is considered quasi-public and need not satisfy the other criteria. The particular type of quasi public entity that is the focus of this memo is not-for-profit entities that receive or expend any amount from dollar one from various public funding sources. Assuming that the not-for-profit does not meet the criteria set forth in R.S. 24:513A(1)(b)(i)-(v), we must decide whether its funding sources meet the definition of “assistance” as defined in R.S. 24:513A(1)(b)(iv). This provision was amended in the 2010 Regular Session by Act 1045 to remove the \$25,000 threshold. The statute now states in pertinent part:

“Any not-for-profit organization that **receives or expends any local or state assistance in any fiscal year. Assistance shall include** grants, loans, transfers of property, awards, and direct appropriations of **state or local public funds**. Assistance shall not include guarantees, membership dues, vendor contracts for goods and services related to administrative support for a local or state assistance program, assistance to private or parochial schools, assistance to private colleges and universities, or benefits to individuals.” (Emphasis added.)

This provision identifies what types of funds must be counted from dollar one that make a not-for-profit entity subject to the audit law. The provision defines assistance to specifically include grants, loans, transfers of property, awards, and direct appropriations of state and/or local public funds. Of particular interest is the fact that the provision uses the words “state” and “local” in describing the funds that are used in the calculation. Thus, every dollar of state or local public funds that are received or expended by a not-for-profit are counted to determine if the entity is a quasi-public entity under R.S. 24:513A(1)(b)(iv). Although R.S. 24:513A(1)(b)(iv) makes no reference to federal funds in defining public assistance, it is appropriate to include federal funds that “pass through” a state or local entity. Therefore, the federal funds are “state and local assistance” tendered by the state or local entity to the non-profit.

This interpretation, however, would not apply to federal funds that are directly appropriated to a state or local not-for-profit entity because there is no state or local involvement. Thus, a direct appropriation of federal funds would not be included in initially determining whether a not-for-profit entity is a quasi-public entity under R.S. 24:513A(1)(b)(iv). However, federal monies transferred as a “pass through” to the entity would be used in that determination because the federal funds would be treated as state or local public assistance.

### III. Subsequent Transfer of Funds

Another issue to consider is the effect of subsequent transfers of “state and local assistance” to a subcontractor of the quasi-public entity. It appears that if the subcontractor receives any amount from dollar one in “state and local assistance” from the quasi-public entity we can assume that this subcontractor is also subject to the audit law. This new subcontractor then becomes a quasi-public entity in its own right.

This interpretation is consistent with the idea of full reporting as described by the Attorney General (AG) in Opinion #02-0204 discussed below. To do otherwise would allow an entity the opportunity to circumvent and frustrate the audit and reporting requirements by transferring federal funds to entities but not auditing the use of those public dollars. This interpretation would have the effect of subverting the intention of the State Legislature and Congress in mandating certain requirements that attach to federal, state or local funds.

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After establishing that an entity is subject to the audit law as a quasi-public entity we must next determine the reporting requirements for local auditees. The reporting requirements address both quasi-public and public entities since both make up the group called local auditees in the audit law.

### IV. What federal funds must local auditees report to the LLA?

The audit law describes reporting requirements for various types of entities. Local auditees are one type of entity that must report financial information to the LLA. Local auditee is a broad term that includes both public and quasi-public entities. The definition of "local auditee" is found in R.S. 24:513A(3). It states in pertinent part:

"The financial statements of the offices of the independently elected public local officials, including judges, sheriffs, clerks of court, assessors, and district attorneys, all parish governing authorities and all districts, boards, and commissions created by parish governing authorities either independently or in conjunction with other units of government, school boards, district public defender offices, municipalities, and all boards and commissions created by municipalities, either independently or in conjunction with other units of government, city courts, quasi public agencies, housing authorities, mortgage authorities, or other political subdivisions of the state not included within the state's Comprehensive Annual Financial Reports, hereinafter collectively referred to as "**local auditee**", shall be audited or reviewed..." (Emphasis added.)

The reporting requirements for local auditees are found in R.S. 24:513J(1)(c)(i)-(iv). These provisions state what must be reported when the local auditee's monies exceed fifty thousand dollars; or two hundred thousand dollars or more; or five hundred thousand dollars or more. It is helpful to compare the manner in which funding sources are defined in R.S. 24:513A(1)(b)(iv) dealing with quasi-public entities to the reporting provisions in R.S. 24:513 J (1)(c)(i)-(iv). In contrast to the description of public assistance as state or local under R.S. 24:513A(1)(b)(iv), the terms used to describe what funds must be reported by local auditees are much broader.

The audit law uses the phrase "revenues and other sources" to describe what funds must be reported by local auditees. Neither "revenue" nor "other sources [of revenue]" are defined in the audit law nor are they limited to only state and/or local revenue or sources. This language stands in sharp contrast to the definition of assistance provided in R.S. 24:513A(1)(b)(iv) defining quasi public entities. Because no definition is provided in the law we must interpret these terms based on their ordinarily understood meaning. Civil Code Article 11 states in part that, "The words of a law must be given their generally prevailing meaning." *Black's Law Dictionary*, 8<sup>th</sup> Edition, defines revenue to mean "gross income or receipts." Public revenue is defined to mean "a government's income, usually derived from taxes, levies and fees." Also, there is no distinction between the varied sources of funding as federal, state, local or private. Thus, a broad range of funds fall within the ordinarily understood meaning of revenue including federal funds. The broad construction of the reporting requirement combined with the lack of a definition of "revenue and other sources" indicates that a wider range of funds are captured in the reporting section of the law as compared with the funds which will define a not-for-profit as a quasi-public subject to the audit law.

The reporting provisions make no distinction as to the manner in which federal funds are received by an entity. Although the law does not provide specific guidance as to "pass through" funds, the AG has concluded that the reporting provision includes "pass through" funds.

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The AG was asked to decide whether federal “pass through” funds transferred from the Louisiana Department of Economic Development (LDED) to the Washington Industrial Development Foundation (WDIF) must be included in financial reports to the Legislative Auditor. The WDIF argued that the funds should not be considered “revenue or other sources” and thus subject to the reporting requirement because it received the federal funds only as “...a pass through mechanism...in trust...and did not have the authority to spend or use any of the funds for its own benefit or pay any of expenses...” The AG acknowledged that the funds were not “...intended to be ‘revenues’ to WDIF because there was no direct benefit to the entity.” However, the AG concluded that the State’s policy of full reporting and the rules of statutory construction required that the funds be reported to the Legislative Auditor. The AG stated in Opinion #02-0204:

**“The State has a clear interest in monitoring and insuring the proper expenditure or transfer of public funds such as those received by WDIF. In our opinion, the fact that the funds merely ‘passed through’ WDIF and were of no direct benefit to WDIF, does not lessen the State’s interest in monitoring or auditing WDIF. As such, it is the opinion of this office that WDIF is required to provide the more detailed financial report...”** (Emphasis added.)

Because the reporting law makes no distinction between the sources of revenue as federal, state or local, monies from all sources should be included. Thus, federal funds derived through any method must be reported along with state and local funds. This requirement would include federal funds that are directly appropriated to a public or quasi-public entity and federal funds that are received as a “pass through” from the state or local government.

### V. Summary

In summary, to determine if a not-for-profit is a quasi-public entity under the audit law, consider only those federal funds that come in the form of state or local assistance. For purposes of deciding reporting requirements for local auditees, except quasi-publics, consider all revenues and other sources of funding that the local auditee receives, regardless of the original source of the funding. These same rules apply to any sub of the original quasi-public entity who subsequently becomes a local auditee.

For quasi-public agencies, the reporting requirement is different than for other local auditees. For these quasi-public agencies who receive state or local assistance when such funds are not commingled with the other funds of the quasi-public agencies, only the state or local assistance funds are considered in determining audit reporting requirements. If the quasi-public does commingle its federal pass through funds, its state assistance, or its local assistance with funds it receives from other sources then the entire commingled amount shall be considered in determining audit reporting requirements. R.S. 24:513J(1)(d)