FEDERAL FUNDS AND THE AUDIT LAW AS THEY RELATE TO QUASI-PUBLIC ENTITIES AND LOCAL AUDITEES' REPORTING

WHITE PAPER

INTRODUCTION

The constitution and statutes charge the Louisiana Legislative Auditor (LLA) with the duty to audit and review the accounts and records of both public and quasi-public entities. R.S. 24:513, *et seq.*, provides LLA with broad authority 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 Louisiana 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 which federal funds must subject entities report? Federal funds may be transferred to a public or quasi-public entity through two different methods: (1) direct appropriation or (2) 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 receiving entity.

The question as to whether a non-profit's receipt of federal funds makes it a quasi-public agency subject to the Audit Law is distinct from the reporting of federal funds under the Audit Law. R.S. 24:513A(1)(b)(i-v) provides five definitions of entities that are deemed quasi-public for purposes of the Audit Law. Among those is "[a]ny not-for-profit organization that receives or expends any local or state assistance in any fiscal year." R.S. 24:513A(1)(b)(iv). Section II of this memo examines this particular type of quasi-public entity, specifically, not-for-profit entities that receive public funds. Section III of this memo examines the effect of the subsequent transfer of public funds to subcontractors/subrecipients. Section IV of this memo addresses the impact of federal funds on reporting requirements under the Audit Law. The specific questions that will be answered are:

1. **Are federal funds that are transferred through direct appropriation considered "assistance" in determining whether a not-for-profit entity is deemed to be a quasi-public entity subject to audit under R.S. 24:513A(1)(b)(iv)?**

2. **Are federal funds that are transferred as "pass through" funds considered "assistance" in determining whether a not-for-profit entity is deemed to be a quasi-public entity subject to audit under R.S. 24:513A(1)(b)(iv)?**

3. **What is the effect of the subsequent transfer of public funds to a subcontractor/subrecipient?**

4. **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 different issues: (1) which not-for-profit entities are subject to audit; and (2) 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 is on whether federal funds are used to decide if a not-for-profit organization is deemed to be a quasi-public entity and thus subject to audit.

The second question deals with the broader issue of reporting requirements. Specifically, in the second instance, the central issue is whether federal funds impact the reporting categories for local auditees.

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

The Audit Law identifies the types of entities that are subject to the Audit Law. Included among the subject entities are quasi-public agencies or bodies. Criteria defined in R.S. 24:513A(1)(b)(i)-(v) determine whether not-for-profit and for-profit entities qualify as quasi-public entities. Each set of criteria stands on its own; in other words, the criteria are independent of one another. Once an entity meets one criterion, it is considered quasi-public and need not satisfy the other criteria. Attorney General **(AG) Op. No. 11-0189A**. 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 entity 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), which provides: :

> **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 except as provided in R.S. 17:4022, 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 to 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 is received or expended by a not-for-profit entity is 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. The federal funds are, therefore, "state and local assistance" tendered by the state or local entity to the non-profit entity.

This interpretation would not, however, 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). Federal monies transferred as a "pass through" to the entity would, however, 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/subrecipient of the quasi-public entity. If the subcontractor/subrecipient receives any amount from dollar one in "state and local assistance" from the quasi-public entity, it appears that this subcontractor/subrecipient is also assumed to be subject to the Audit Law. This subcontractor/subrecipient then becomes a quasi-public entity in its own right.

This interpretation is consistent with the idea of full reporting as described by the AG in **AG Op. No. 02-0204** discussed below. To reason otherwise would allow an entity the opportunity to circumvent and frustrate the audit and reporting requirements by transferring federal funds to entities where the use of those public dollars would not be audited. Failing to make a subcontractor/subrecipient a quasi-public entity would have the effect of subverting the intent of the State Legislature and Congress in mandating certain requirements that attach to federal, state or local funds.

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 because both compose 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. 24:513(A)(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, all political subdivisions created by parish governing authorities or by law, 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, all political subdivisions created by municipal governing authorities, 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 Annual Comprehensive Financial Reports required pursuant to R.S. 39:80, hereinafter collectively referred to as "local auditee", shall be audited or reviewed…** (Emphasis added.)

The annual reporting requirements for local auditees are found in R.S. 24:513(J)(1)(c)(i)-(iv). These provisions state the different reporting requirements depending on whether the local auditee's monies exceed (1) $75,000; or (2) $200,000; or (3) $500,000. Comparing 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) may be helpful. 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 which funds must be reported by local auditees are much broader.

The Audit Law uses the phrase "revenues and other sources" to describe the funds that must be reported by local auditees. Neither "revenue" nor "other sources [of revenue]" is defined in the Audit Law, nor is either limited to only state and/or local revenue or sources. The phrase "revenues and other sources" contrasts sharply to the definition of "assistance" provided in R.S. 24:513(A)(1)(b)(iv) to define quasi-public entities. Because no definition is provided in the law, the terms are interpreted 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*, 11th Edition, defines revenue to mean "Income from any and all sources; gross income or gross receipts." Public revenue is defined to mean "a

government's income, usually derived from taxes, levies and fees." Also, no distinction is made among the varied sources of funding as federal, state, local or private.

Thus, a broad range of public funds falls within the ordinarily understood meaning of "revenue," including federal funds. The broad construction of the reporting requirement, combined with the absence of a definition of "revenue and other sources" indicate that a wider range of funds is captured in the reporting section of the law -- as compared with the funds that define a not-for-profit entity as a quasi-public entity that is 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.

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."

The AG concluded, however, 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 **AG Op. No. 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 (federal, state or local), monies from all sources should be included. Thus, once it is determined that an entity is subject to the Audit Law (whether by virtue of being a public entity or a quasi-public agency), all federal funds derived through any method must be reported along with state and local funds. This requirement includes federal funds that are directly appropriated to a public or quasi-public entity, as well as federal funds that are received as a "pass through" from the state or local government.

As a reminder, some quasi-public agencies may receive both public and private funds. For these quasi-public agencies, it is important to distinguish between public funds and private funds regarding reporting requirements. For quasi-public agencies that receive public funds (whether federal, state or local assistance) and do not commingle the funds with the other private funds of the quasi-public agencies, only public funds are considered in determining audit reporting requirements, including supplemental reporting under R.S. 24:513(A)(3). If the quasi-public does commingle its public funds with funds it receives from other sources, then the entire commingled amount shall be considered in determining audit reporting requirements.

R.S. 24:513(J)(1)(d)

The supplemental reporting required of local auditees under R.S. 24:513(A)(3) also makes a distinction between public entities and not-for-profit quasi-public agencies. The agency head, political subdivision head or chief executive officer of a local auditee is required to report their compensation, reimbursements, and benefits as a supplemental report within the annual financial statements of the local auditee. For public entities, this reporting, except in the case of the reporting of judicial expense and court building funds, shall require reporting of amounts received by the agency head, political subdivision head, or chief executive officer regardless of source. Nongovernmental and not-for-profit organizations are only required to report those amounts received or tendered from public funds (state or local assistance, including Federal pass through funds).

Summary

In summary, to determine if a not-for-profit organization is a quasi-public entity under the Audit Law due to its receipt of public funds, consider only those federal funds received in the form of state or local assistance as defined in R.S. 24:513(A)(1)(b)(iv). For purposes of deciding reporting requirements for local auditees, including quasi-public entities, 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 subcontractor/subrecipient of the original quasi-public entity.

To revisit the initial questions posed at the beginning of this memo:

1. **Are federal funds that are transferred through direct appropriation considered "assistance" in determining whether a not-for-profit entity is deemed to be a quasi-public entity subject to audit under R.S. 24:513A(1)(b)(iv)?**

   No.

2. **Are federal funds that are transferred as "pass through" funds considered "assistance" in determining whether a not-for-profit entity is deemed to be a quasi-public entity subject to audit under R.S. 24:513A(1)(b)(iv)?**

   Yes.

3 **What is the effect of the subsequent transfer of public funds to a subcontractor/subrecipient?**

   The subcontractor/subrecipient becomes a quasi-public entity.

4. **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)?**

   Yes.