



SOUTH CAROLINA REVENUE AND FISCAL AFFAIRS OFFICE
STATEMENT OF ESTIMATED FISCAL IMPACT
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This fiscal impact statement is produced in compliance with the South Carolina Code of Laws and House and Senate rules. The focus of the analysis is on governmental expenditure and revenue impacts and may not provide a comprehensive summary of the legislation.

Bill Number: S. 0031 Introduced on January 10, 2023
Author: Hutto
Subject: Municipal Audit
Requestor: Senate Finance
RFA Analyst(s): Tipton
Impact Date: February 13, 2023

Fiscal Impact Summary

This bill eliminates the annual financial record audit requirement under §5-7-240 for municipalities in the state with less than \$500,000 in total annual revenue. In lieu of an audit, these municipalities may elect to compile financial statements. This compilation must be provided annually if the municipality has a court system or every three years if the municipality does not have a court system. The compilation of statements must be prepared by a certified public accountant in accordance with agreed upon procedures. The \$500,000 limit for conducting an audit will increase with inflation. The bill also increases the limit that municipalities may retain from court fines and fees from \$1,000 to \$2,000 to pay the expenses associated with the preparation of the Uniform Supplemental Schedule Form required to be submitted with the audit or compiled financial statement.

This bill will have no expenditure impact on the State Treasurer's Office (STO) or the Office of State Auditor (OSA) as the development of regulations and procedures as well as review of financial statement compilation required by the bill will be managed by these agencies with existing staff and appropriations.

This bill may reduce revenue generated by municipal court fines and assessments collected pursuant to §14-1-208(A) for the General Fund by up to \$23,060 and Other Funds by up to \$154,620, assuming that every qualifying municipality in the state retains an additional \$1,000 of court fines as allowed by the bill for the purposes of conducting an audit or compilation of financial statements.

This bill will reduce local expenditures for municipalities with total annual revenues of less than \$500,000 beginning in FY 2024-25. The bill does not define total revenue for the purposes of determining whether a municipality is eligible for financial statement compilation in lieu of an annual audit, however, based on the Revenue and Fiscal Affairs Office (RFA) 2021 Local Government Finance Report, 48 to 58 municipalities would qualify depending on the inclusion of utility fund revenues in the total revenue calculation. However, 73 municipalities in the state did not submit financial information for the report, indicating that total revenues for those municipalities may also fall below the \$500,000 threshold set by the bill. Therefore, we estimate that between 48 and 121 municipalities in the state will have total annual revenues of less than

\$500,000 in FY 2023-24 and will be eligible for financial statement compilation under this bill beginning in FY 2024-25 in lieu of an annual audit.

Based on the cost of financial statement compilation of between \$500 and \$2,000 compared to approximately \$5,000 for an audit, expenditure savings could range from \$3,000 to \$4,500 for each qualifying municipality. These savings would increase to up to \$5,000 for approximately 71 municipalities in the state without a court system, as those municipalities would be exempt from all financial reporting requirements until FY 2027-28. Local expenditure savings would be further bolstered by the additional court fine revenue retained by the municipality under this bill. However, based on the State Treasurer's delinquent audit list for municipalities, 31 municipalities have not submitted an annual audit to STO for the last two required fiscal years. If these municipalities are not currently conducting audits, it is unknown whether these municipalities would comply with the financial statement compilation requirement of this bill and therefore reap the expenditure savings benefit. The Municipal Association of South Carolina (MASC) reports that in some cases, performing a professional audit is cost prohibitive for small municipalities, while compiling financial statements may be more feasible. However, it is unknown how many of the municipalities on STO's delinquent audit list would fall in this category, and therefore, actual local expenditure savings as a result of the bill are undetermined.

This bill will reallocate municipal court fine revenue of up to \$22,320 beginning in FY 2023-24 for the purposes of conducting an audit or financial statement compilation, assuming that all municipalities with a court system will retain an additional \$1,000 as allowed by the bill. Additionally, municipalities on the STO's delinquent audit list are expected to lose all Local Government Fund (LGF) distributions in FY 2022-23, totaling approximately \$527,900 for municipalities whose delinquency has lasted two fiscal years or more. However, the number of currently delinquent municipalities that will comply with the financial statement compilation requirement of the bill is unknown, and therefore, the LGF revenue impact for municipalities is undetermined.

Explanation of Fiscal Impact

Introduced on January 10, 2023

State Expenditure

This bill eliminates the annual audit requirement under §5-7-240 for municipalities in the state with less than \$500,000 in annual revenue. In lieu of an audit, these municipalities may elect to compile financial statements. This compilation must be provided annually if the municipality has a court system or every three years if the municipality does not have a court system. The compilation of statements must be prepared by a certified public accountant in accordance with agreed upon procedures as established by STO and approved by OSA.

State Treasurer's Office. This bill requires STO to establish procedures for financial statement compilation for municipalities with total annual revenues of less than \$500,000. In addition, this bill may increase in the number of LGF distributions from STO to municipalities currently on the STO's delinquent audit list, if compliance with the financial statement compilation requirement is more common than the audit requirement. STO currently withholds all LGF distributions to

municipalities that have not complied with the annual audit requirement in a given fiscal year, totaling approximately \$500,000 since FY 2018-19. STO indicates that the development of procedures for financial statement compilation and increased LGF distributions will be managed by existing staff and appropriations and will have no expenditure impact.

Office of State Auditor. This bill requires approval from OSA of procedures established by STO for financial statement compilation for municipalities with total annual revenues of less than \$500,000. OSA indicates that this will be managed by existing staff and appropriations and will have no expenditure impact.

State Revenue

This bill eliminates the annual financial record audit requirement under §5-7-240 for municipalities in the state with less than \$500,000 in total annual revenue. In lieu of an audit, these municipalities may elect to compile financial statements. This compilation must be provided annually if the municipality has a court system or every three years if the municipality does not have a court system. The compilation of statements must be prepared by a certified public accountant in accordance with agreed upon procedures. The \$500,000 limit for conducting an audit will increase with inflation. The bill also increases the limit that municipalities may retain from court fines and fees collected pursuant to §14-1-208(A) from \$1,000 to \$2,000 to pay the expenses associated with the preparation of the Uniform Supplemental Schedule Form required to be submitted with the audit or compiled financial statement. Under this code section, a person who is convicted of, or pleads guilty or nolo contendere to, or forfeits bond for an offense, tried in municipal court must pay an amount equal to 107.5 percent of the fine imposed as an assessment. This assessment, less the amount retained by the municipality, must be remitted to the State Treasurer and distributed in specified amounts.

Of the 271 municipalities in the state, Judicial estimates that approximately 200 have court systems. If we assume that every municipality with a court system will retain an additional \$1,000 in municipal court fines received pursuant to §14-1-208(A) for the purposes of performing an audit or compilation of financial statements, this will reallocate approximately \$200,000 of court assessments revenue statewide. Pursuant to §14-1-208(C), 11.53 percent of these fines and assessments must be remitted to the General Fund, 11.16 percent may be retained by municipalities, and the remaining 77.31 percent must be distributed to various Other Funds sources for victim services. Therefore, under the increased retention amount for conducting an audit or financial statement compilation, this bill may reduce revenue generated by municipal court fines and assessments for the General Fund by up to \$23,060 and Other Funds by up to \$154,620 beginning in FY 2023-24.

Local Expenditure

This bill eliminates the annual financial record audit requirement under §5-7-240 for municipalities in the state with less than \$500,000 in total annual revenue. In lieu of an audit, these municipalities may elect to compile financial statements. This compilation must be provided annually if the municipality has a court system or every three years if the municipality does not have a court system. The compilation of statements must be prepared by a certified public accountant in accordance with agreed upon procedures. The \$500,000 limit for

conducting an audit will increase with inflation. The bill also increases the limit that municipalities may retain from court fines and fees from \$1,000 to \$2,000 to pay the expenses associated with the preparation of the Uniform Supplemental Schedule Form required to be submitted with the audit or compiled financial statement.

This bill does not define total revenue for the purposes of determining whether a municipality is eligible to compile financial statements in lieu of an annual audit. According to RFA's 2021 Local Government Finance Report, the number of reporting municipalities with revenue of less than \$500,000 ranges from 48 to 58 depending on how total revenue is determined. Based on the report, 48 responding municipalities reported total revenues of less than \$500,000 when including all utility revenue. The number of responding municipalities with less than \$500,000 in revenue increases to 55 when excluding enterprise utility funds but including all General Fund utility revenue, and further increases to 58 when excluding all utility fund revenue. However, 73 municipalities in the state did not submit financial information for the Local Government Finance Report, indicating that total revenues for those municipalities may fall below the \$500,000 threshold set by the bill. Therefore, we estimate that between 48 and 121 municipalities in the state will have total annual revenues of less than \$500,000 in FY 2023-24 and will be eligible for financial statement compilation under this bill beginning in FY 2024-25 in lieu of an annual audit.

According to the MASC, the annual cost of an audit for a municipality with less than \$500,000 in revenue varies, but is estimated to be approximately \$5,000. The cost of compiling financial statements in lieu of an audit would vary based on the complexity of the municipality's finances, and would be between \$500 and \$2,000 per year. Thus, expenditure savings would range from \$3,000 to \$4,500 annually for each qualifying municipality. Expenditure savings would increase to up to \$5,000 for approximately 71 municipalities in the state without a court system in FY 2025-26 and FY 2026-27, as those municipalities would be exempt from all financial reporting requirements until FY 2027-28. Local expenditure savings would be further bolstered by the additional court fine revenue retained by the municipality under this bill.

However, based on the STO's delinquent audit list for municipalities, 31 municipalities have not submitted an annual audit to STO for the last two applicable fiscal years. If these municipalities are not currently conducting audits, it is unknown whether these municipalities would comply with the financial statement compilation requirement of this bill and therefore reap the expenditure savings benefit. MASC reports that in some cases, performing a professional audit is cost prohibitive for small municipalities, while compiling financial statements may be more feasible. However, it is unknown how many of the municipalities on STO's delinquent audit list would fall in this category, and therefore, actual local expenditure savings as a result of the bill are undetermined.

Local Revenue

This bill eliminates the annual financial record audit requirement under §5-7-240 for municipalities in the state with less than \$500,000 in total annual revenue. In lieu of an audit, these municipalities may elect to compile financial statements. This compilation must be provided annually if the municipality has a court system or every three years if the municipality

does not have a court system. The compilation of statements must be prepared by a certified public accountant in accordance with agreed upon procedures. The \$500,000 limit for conducting an audit will increase with inflation.

The bill further increases the limit that municipalities may retain from municipal court fines received pursuant to §14-1-208(A) for performing the audit or financial statement compilation from \$1,000 to \$2,000. Of the 271 municipalities in the state, Judicial estimates that approximately 200 have court systems. If we assume that every municipality with a court system will retain an additional \$1,000 in municipal court fines received pursuant to §14-1-208(A) for the purposes of performing an audit or compilation of financial statements, this will reallocate approximately \$200,000 of court fines and assessments revenue statewide. Pursuant to §14-1-208(C), 11.53 percent of these fines and assessments must be remitted to the General Fund, 11.16 percent may be retained by municipalities, and the remaining 77.31 percent must be distributed to various Other Funds sources for victim services. Therefore, under the increased retention amount for conducting an audit or financial statement compilation, this bill may reallocate local revenue generated by municipal court fines and assessments by up to \$22,320 beginning in FY 2023-24.

Currently, local governments that do not perform an annual audit are subject to the loss of all LGF distributions in a given fiscal year. According to the STO, approximately \$500,000 of LGF distributions were withheld from municipalities since FY 2018-19. LGF distributions to municipalities that have been on the STO's delinquent audit list for the last two applicable fiscal years are estimated to total \$527,900 in FY 2022-23, which would be forfeited should the municipalities continue to be in violation of the audit requirement. If those municipalities begin performing annual financial statement compilations under the provisions of this bill, LGF revenue to delinquent municipalities could increase by up to \$527,900 statewide. However, as the number of currently delinquent municipalities that would comply with this bill are unknown, the revenue impact is undetermined.



Frank A. Rainwater, Executive Director