

SMART START – DIRECT SERVICE PROVIDERS (DSP)

State Authorization: General Statute (G. S.) 143B-168.10 - 143B-168.16 and Session Law 2018-5.

**N. C. Department of Health and Human Services
Division of Child Development and Early Education**

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SFY 2020 audit confirmation reports for payments made to Counties, Local Management Entities (LMEs), Managed Care Organizations (MCOs), Boards of Education, Councils of Government, District Health Departments and DHSR Grant Subrecipients will be available by mid-October at the following web address:

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<https://www.ncdhhs.gov/about/administrative-offices/office-controller/audit-confirmation-reports>
At this site, click on the link entitled “Audit Confirmation Reports (State Fiscal Year 2019-2020). Additionally, audit confirmation reports for Nongovernmental entities receiving financial assistance from DHHS are found at the same website except select “Non-Governmental Audit Confirmation Reports (State Fiscal Years 2018-2020).”

The Auditor should not consider the Supplement to be “safe harbor” for identifying audit procedures to apply in a particular engagement, but the Auditor should be prepared to justify departures from the suggested procedures. The Auditor can consider the Supplement a “safe harbor” for identification of compliance requirements to be tested if the Auditor performs reasonable procedures to ensure that the requirements in the Supplement are current. The grantor agency may elect to review audit working papers to determine that audit tests are adequate.

I. PROGRAM OBJECTIVES

The objective of Smart Start is to explore and effect innovative community-based approaches and strategies for aiding parents and families in the education and development of preschool children. State legislation (G. S. 143B-168.11) establishes The North Carolina Partnership for Children, Inc. (NCPC) for the purpose of developing a comprehensive, long-range strategic plan for early childhood development and the provision, through public and private means, of high-quality early childhood education and services for children and families.

II. PROGRAM PROCEDURES

Smart Start funds are allocated to local partnerships by NCPC. Local partnerships, in turn, make decisions through their planning process about the use of their allotments. This supplement is targeted for Direct Service Providers (DSPs), the agencies that receive funds from local partnerships. Not less than thirty percent (30%) of the funds spent in each year of each local partnership's direct services allocation shall be used to expand

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child care subsidies. To the extent practicable, these funds shall be used to enhance the affordability, availability, and quality of child care services as described in this section. The North Carolina Partnership may increase this percentage requirement up to a maximum of fifty percent (50%) when, based upon a significant local waiting list for subsidized child care the North Carolina Partnership determines a higher percentage is justified. Local partnerships shall spend an amount for child care subsidies that provides at least fifty-nine million dollars (\$59,000,000) for the Temporary Assistance to Needy Families (TANF) maintenance of effort requirement and the Child Care Development Fund and Block Grant match requirement (G.S. 143B-168.15. (g) and page 110 of Session Law 2018-5 under Child Care and Development Fund Block Grant 01. Child Care Services). Services provided by the local department of social services in agreement with the local partnership are set forth in Smart Start Funding Authorizations sent out by the Division of Child Development and Early Education (DCDEE) of NCDHHS.

Smart Start funds also may be allotted by local partnerships to other public and private agencies (DSP) to purchase goods and services to benefit young children and their families. Activities to be performed by the DSPs are outlined in Attachment I to the local partnership's contract with NCPD. The local partnerships will also have a separate contract with the DSP.

In SFY 1997-98, all 100 counties were finally brought into the Smart Start program and local partnerships are now operating for all counties. Each local partnership develops a plan to support activities and services that will be made available and accessible to providers, children and families on a voluntary basis.

Smart Start's Comprehensive Approach

North Carolina has taken a holistic approach to serving the needs of children through its Smart Start program. It recognizes that services must touch all facets of a child's environment in the early years. While specific programs differ from county to county, Smart Start funds support local programs and services that focus on young children in four core categories. The four core areas are:

- **Child Care and Education Quality** – improving the quality of child care and early childhood education;
- **Child Care and Education Affordability** – making child care and early education affordable to all families;
- **Health and Safety** – giving each child access to comprehensive health care; and
- **Family Support** – getting families the information and resources they need to support the emotional, intellectual and physical development of their children.

To early childhood experts, there are four key components of *quality*, out-of-home care that will most benefit young children: 1) low child-to-teacher ratios, 2) small groups of children, 3) staff that is well trained and educated, and 4) workers that stay in their jobs long enough to form stable bonds with children. Smart Start focuses on ways to enhance the quality of child care by influencing these same components. Local partnerships may offer incentives to child care programs that work to obtain a higher level of licensure; or to pay for teacher training or to support increased compensation to a child care provider tied to education level and length of stay at a child care center.

As child care is increasingly recognized as a major link between welfare and work, more and more Smart Start funding is allocated for child care subsidies to low income, working

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families. Smart Start has helped to reduce the waiting lists for child care in many counties. While ensuring that care is affordable for all children is a top priority, subsidizing child care also presents a unique opportunity to help improve the quality of care by tying subsidy dollars to the care that the parents purchase.

Health and safety programs funded with Smart Start focus on prevention and help fill gaps in child health care services. In some counties, there is a sufficient supply of both health providers and services, but consumers are unaware of or cannot access them. Other counties face shortages in health programs due to their remote location or inability to attract qualified providers. Ultimately, school readiness depends upon the healthy development of young children and early detection of health-related problems and developmental delays.

Smart Start supports parent education regarding the importance of early preventive health care, and training for medical providers to complete developmental screenings along with well-child check-ups. Smart Start also funds support for community and child care obesity prevention activities and child care health consultation to assure safe and healthy environments in child care.

Family support programs are the fourth core service provided through Smart Start. Studies have shown that children who have not received sensitive, responsive adult care are more likely to have lower levels of school achievement, require special education by grade 3, exhibit more behavioral problems, and use drugs and alcohol during adolescence. Teen mothers, parents with less than a high school education, or parents in an abusive or violent relationship may be unable to provide the appropriate nurturing so vital to their young children.

Smart Start programs provide support to families with young children through parent education, home visiting programs, education on what to look for when choosing care, and early literacy programs.

Evaluation & Monitoring of Smart Start

The North Carolina Partnership for Children, Inc. shall make a report no later than December 1 of each year to the General Assembly.

Monitoring of Smart Start occurs in many ways. The NC Office of the State Auditor conducts an annual audit of NCPC and, no less frequently than biennially, each local partnership is audited by an independent auditor. This work ensures the fiscal accountability for all public and private funds going to Smart Start.

Contract monitoring occurs at both the State and local level for compliance with competitive bidding practices, established policies and procedures, compliance with contractual requirements and requests for funds based upon actual expenditures. Accountability for performance is monitored through the annual planning process and with outcome data reported annually to the State. Smart Start also has uniform population-based performance indicators to monitor community impact annually.

III. COMPLIANCE REQUIREMENTS – DIRECT SERVICE PROVIDER (DSP)

1. ACTIVITIES ALLOWED OR UNALLOWED

Compliance Requirements – The North Carolina Constitution and supporting legal cases require that all State funds are expended for a public purpose.

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The four core activities for which Smart Start funds may be spent are:

- **Child Care and Education Quality** – improving the quality of child care and early childhood education;
- **Child Care and Education Affordability** – making child care and early education affordable to all families;
- **Health and Safety** – giving each child access to comprehensive health care; and
- **Family Support** – getting families the information and resources they need to support the emotional, intellectual and physical development of their children.

Services provided under Smart Start contracts are limited to those within an approved local partnership annual plan and allowed by G. S. 143B-168.15. Also see Session Law 2018-5.

Note that Section 11B.8. (h) of Session Law 2018-5 prohibits capital expenditures and the expenditure of State funds for advertisement or promotional activities for the 2017-2019 fiscal biennium.

Audit Objectives – Determine whether State awards were expended only for allowable activities. The allowable activities should be defined in the Smart Start contract(s) through which funds were provided to the DSP for the period being audited.

Suggested Audit Procedures

1. Review the activity description in grant or contract and determine if the activity meets the definition of one of the core activities.
2. Auditor should design audit procedures to determine that costs charged to the program are in accordance with approved activities pursuant to the contract terms.

2. ALLOWABLE COSTS/COST PRINCIPLES

Compliance Requirements – Effective July 1, 2005, North Carolina adopted rules that identified cost principles for grants of State funds (09 NCAC 03M-0201). These cost principles were integrated into the Smart Start Cost Principles, which applied to all DSPs, effective July 1, 2005. These Cost Principles were updated as of July 1, 2012, August 1, 2016, July 1, 2017, and July 1, 2018.

In addition, the State has adopted general criteria for allowable costs. The general criteria affecting allowability of costs under State awards are as follows:

1. Costs must be reasonable and necessary for the performance and administration of the award/grant and be allocable to the activity.
2. Costs must be authorized or not prohibited under State or local laws/regulations and approved by the funding agency.
3. Costs must conform to any limitations or exclusions set forth in the grant award as to type or amount of cost items.

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4. Costs must be consistent with policies and procedures that apply uniformly to both State financed programs and other activities of the grantee organization.
5. Costs must be accorded consistent treatment and be determined in accordance with either generally accepted accounting principles or another comprehensive basis of accounting stipulated by the granting agency.
6. With the exception of the NC Pre-Kindergarten Program, costs must not be included as a cost or used to meet cost-sharing or matching requirements of another State financed program in either the current or prior period.
7. Costs must be adequately documented with time and attendance payroll records, personnel activity reports, or other time and effort records for employees charged to State awards or to more than one activity. Other types of documentation may include approved purchase orders, receiving reports, vendor invoices, canceled checks, etc. In addition, the costs must be correctly charged on the financial records as to account, amount, and period.
8. Costs must be net of all applicable credits that result from transactions that reduce or offset costs. Examples of such transactions include purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates and adjustments for overpayments or erroneous charges.
9. A cost is considered to be reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time a decision is made to incur the cost. Consideration must be given to whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization, the performance of the award, or the provision of services.
10. A cost is allocable to a particular cost objective, such as a grant, project, service, or other activity, in accordance with the relative benefit received by the cost objective. In order for a cost to be allocable to a State grant or award, the cost must be treated consistently with other costs incurred for the same purpose under like circumstances. The cost must benefit both the award and other activities of the organization and be distributed to the cost objective in a reasonable proportion to the benefits received although a direct relationship to a particular cost objective cannot be shown. It should be noted that any cost allocable to a particular award or cost objective cannot be shifted to other State awards either to overcome funding deficiencies or to avoid restrictions imposed by law or by the terms of the award. NCPC issued Cost Allocation Guidelines effective July 2003 that are applicable to all local partnerships.

Audit Objectives – Determine whether:

- A. Charges made to State awards were for allowable costs; and
- B. Methods of allocating costs to State awards produce an equitable distribution.

Suggested Audit Procedures

Test a sample of transactions for compliance with the following criteria:

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1. Complied with the allowability of costs provisions of or limitations in the program agreement, program regulations, Smart Start Cost Principles, Cost Allocation Guidelines or program statute.
2. Represented charges for actual costs, not budgeted or projected amounts.
3. Calculated in conformity with generally accepted accounting principles or another comprehensive basis of accounting when required.
4. Supported by appropriate documentation, such as approved purchase orders, receiving reports, vendor invoices, canceled checks, or time and attendance records, and correctly charged as to account, amount, and period. Documentation requirements for salaries and wages and time and effort distribution are described in Title 2 CFR, Part 200, Subpart E. Documentation may be in an electronic form.
5. Not included as a cost or used to meet cost sharing requirements of other State-supported activities of the current or a prior period.
6. Determine that the costs charged are in accordance with the organization's approved indirect cost plan and NCP's Cost Allocation Guidelines. Determine if cost allocation methodologies appear reasonable. Review the contract to determine if indirect costs are an allowable charge to the program.

3. CASH MANAGEMENT

Compliance Requirements – When entities are funded on a reimbursement basis, program costs must be paid for by entity funds before reimbursement is requested from a State agency. When funds are advanced, recipients may be required to follow specific procedures. Smart Start funds are frequently advanced.

Audit Objectives – Determine whether:

1. The DSP followed procedures established by the applicable sections of the contract with the local partnership; and
2. The DSP implemented procedures to assure that subrecipients conformed to the same requirements that applied to the local partnership.

Suggested Audit Procedures

1. Select a sample of disbursements of State funds and compare to the dates the funds were disbursed. Verify that the funds disbursed comply with the payment provisions in the DSP contract.
2. Select a sample of payment requests (Financial Status Reports) and verify amounts paid to DSPs were correctly calculated and that the local partnership performed accurate reconciliations of the Financial Status Reports.
3. Determine that any unexpended funds held by the DSP were reported to the local partnership with the final claim for reimbursement. Payment for the final claim should have been reduced by this amount. If the remaining unexpended funds were in excess of the final claim for payment, the DSP should have returned the excess funds to the local partnership within time frames required by the local partnership.

4. CONFLICT OF INTEREST

Compliance Requirements – Nongovernmental Organizations

DSPs are required by their contracts with the local partnerships to formally adopt a policy which addresses conflicts of interests that might arise involving the entity's management, employees, and/or board members. The policy statement is expected to address situations in which any of the above referenced individuals may directly or indirectly benefit from the entity's disbursement of funds received from the State. In addition, the policy should specify actions to be taken by the entity or individuals or both to avoid either actual conflicts of interest or the appearance of an impropriety. Before a private, not-for-profit entity receives and disburses State funds, the entity should have adopted and have on file a copy of the policy statement.

Audit Objective – Determine whether the DSP, before receiving and disbursing State funds, has adopted and has on file a conflict of interest policy and that the DSP was in compliance with the policy.

Suggested Audit Procedures

1. Ascertain that the DSP has a conflict of interest policy in accordance with its contract with the local partnership.
2. Check the policy and verify through board minutes that a policy was adopted before the DSP received and disbursed State funds. Also, from review of board activities, determine that the DSP is in compliance with this policy.

5. ELIGIBILITY

Compliance Requirements – The specific requirements for eligibility are unique to each State program and are found in legislation and the provisions of contract or grant agreements pertaining to the program. The best source of information about subrecipients to be served is the local partnership's plan that has been approved by NCPC and the DSPs contract work plan.

Audit Objectives – Determine whether:

1. Required eligibility determinations were made, (including obtaining any required documentation/verifications) and that subrecipients (including area of service delivery) were determined to be eligible. Only eligible subrecipients (including area of service delivery) participated in the program.
2. Subawards were made only to eligible subrecipients.
3. Amounts provided to or on behalf of eligible subrecipients were calculated in accordance with program requirements.

Suggested Audit Procedures

1. Determine the eligibility criteria related to the performance of the contract.
2. Review to determine if an eligibility determination system is in place.
3. Perform sample tests to determine if eligibility criteria are being followed.

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- a. Specific subrecipients were eligible in accordance with the compliance requirements of the program. (Note that some programs have both initial and continuing eligibility requirements and the auditor should design and perform appropriate tests for both.)
- b. Benefits paid to or on behalf of the subrecipients were calculated correctly and in compliance with the requirements of the program.
- c. Benefits were discontinued when the period of eligibility expired.

6. EQUIPMENT AND REAL PROPERTY MANAGEMENT

Compliance Requirements – The specific requirements for equipment management are as follows:

The DSP agrees that it shall be responsible for the proper custody and care of any property furnished to it for use in connection with the performance of the contract and will reimburse the local partnership for loss of, or damage to, such property. When the property provided or purchased is no longer needed or used for the performance of services under the contract, or at the termination of the contract, the DSP shall contact the local partnership for instructions as to the disposition of such property and shall comply with these instructions.

For personal property costing in excess of \$500 per item, controls and procedures shall include at a minimum the following:

1. Detailed asset records that accurately include description and location of the asset, acquisition date, cost, and serial number, if applicable.
2. A control system shall be in place to ensure adequate safeguards to prevent loss, damage, or theft of personal property.
3. Adequate maintenance procedures to ensure that property is maintained in good condition.

Audit Objectives – Determine whether:

1. The DSP maintains proper records for equipment and adequately safeguards and maintains equipment; and
2. Disposition of any equipment acquired with State awards is in accordance with the requirements of the awarding agency.

Suggested Audit Procedures

1. Obtain the DSP's policies and procedures for equipment management and ascertain if they comply with the awarding agency's policies and procedures.
2. Select a sample of equipment transactions and test for compliance with the awarding agency's policies and procedures for management and disposition of equipment.

Identify equipment acquired under State awards during the audit period and trace selected purchases to the property records. Verify that the property records contain information about the equipment required by the awarding State agency. Such information could include a description (including serial number or other identification number), source, who holds title, acquisition date and cost, percentage of State participation in the cost, location, condition, and any ultimate disposition data including the date of disposal and sales price or method used to determine current fair market value.

3. Select a sample of equipment identified as acquired under State awards from the property records and physically inspect the equipment including whether the equipment is appropriately safeguarded and maintained.
4. Dispositions of Equipment
 - a. Determine the amount of equipment dispositions for the audit period and perform procedures to verify that dispositions were made in accordance with the awarding agency's requirements.
 - b. For dispositions of equipment acquired under State awards, perform procedures to verify that the dispositions were properly reflected in the property records.

8. PERIOD OF PERFORMANCE

Compliance Requirements – Smart Start contracts specify a time period during which the contractor may use the State funds. Where a funding period is specified, a contractor may charge to the award only costs resulting from cash disbursements that occur during the funding period.

Audit Objective – Determine whether State funds were disbursed within the period of availability.

Suggested Audit Procedures

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1. Review the award documents and regulations pertaining to the program and determine any award-specific requirements related to the period of availability and document the availability period.
2. Determine that all costs were expended prior to the end of the contract period.
3. Review for prepayments or for disbursements after the end of the contract period. All such activity should have prior approval from the funding entity.
4. Select a sample of adjustments to the State funds and verify that these adjustments were for transactions that occurred during the period of availability.

9. PROCUREMENT AND SUSPENSION AND DEBARMENT

Compliance Requirement – Smart Start DSPs are prohibited from entering into a contract with a party that has been suspended or debarred by the State of North Carolina.

Audit Objective – To determine that the Smart Start DSP has not entered into a contract with a party that has been suspended or debarred by the State of North Carolina.

Suggested Audit Procedure – Test a sample of contracts and verify that the DSP has not entered into a contract with a party that has been suspended or debarred by the State of North Carolina. A list of debarred parties can be found at <http://www.pandc.nc.gov/actions.asp>.

10. PROGRAM INCOME

Compliance Requirements

1. Program income is defined as follows: “Program income includes, but is not limited to, income from fees for services performed, the use or rental of real or personal property acquired with State funds, the sale of commodities or items fabricated under a grant agreement, etc. Interest earned on State funded deposits is considered to be program income.”
2. Program income must only be spent to enhance the activities performed under the contract or to decrease the cost to the local partnership of performing those activities; it cannot be used towards administrative costs. Program income may only be expended on approved activities.
3. Written authorization to expend program income by a DSP must be obtained from the local partnership prior to expenditure.
4. DSP program income must be expended in the year earned.
5. All program income at the DSP unexpended as of June 30th of the year earned must be reverted to the local partnership. The local partnership must spend the DSP program income by June 30 of the fiscal year following the fiscal year the program income was earned by the DSP or revert the program income to NCPD.

Audit Objectives – Determine whether program income was:

1. Earned in current year;
2. Expended appropriately in current year;
3. Accounted for; and
4. Correctly reported to the local partnership, with any excess returned to the local partnership.

Suggested Audit Procedures

1. Review accounting records for program income to determine if the income was properly accounted for, was expended in the appropriate period, and was expended for services ONLY.
2. Review authorization from the local partnership to the DSP to expend program income.
3. Determine that all program income unexpended at the end of the fiscal year was reverted to the local partnership.

12. REPORTING

Compliance Requirements

Financial Reporting

The specific requirements for financial reporting are found in the provisions of the Smart Start local partnership contract with the DSP.

Program Reporting

The specific contract requirements for program reporting are found in the contracts with the contracting entity.

Audit Objective – Determine whether required reports for State awards include all activity of the reporting period, are supported by applicable accounting or performance records, and are fairly presented in accordance with program requirements.

Suggested Audit Procedures

1. Obtain an executed copy of the contract and review applicable provisions of contract agreements pertaining to the program for reporting requirements. Determine the types and frequency of required reports. Obtain and review instructions for completing the reports.
 - a. For financial reports, ascertain the accounting basis used in reporting the data (e.g., cash or accrual). The Smart Start program requires the use of the cash basis of accounting for reporting purposes.
 - b. For program reports, determine the criteria and methodology used in compiling and reporting the data.

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2. Perform appropriate analytical procedures and ascertain the reason for any unexpected differences. Examples of analytical procedures include:
 - a. Comparing current period reports to prior period reports;
 - b. Comparing anticipated results to the data included in the reports; and
 - c. Comparing information obtained during the audit of the financial statements to the reports.

Note: The results of the analytical procedures should be considered in determining the nature, timing, and extent of the other audit procedures for reporting.

3. Select a sample of each of the following report types:
 - a. Financial reports:
 - (1) Ascertain if the financial reports were prepared in accordance with the required accounting basis.
 - (2) Trace the amounts reported to accounting records that support the audited financial statements and the schedule of expenditures of State awards and verify agreement or perform alternative procedures to verify the accuracy and completeness of the reports and that they agree with the accounting records.
 - (3) Ascertain that financial reports were submitted when due.
 - b. Program reports:
 - (1) Trace the data to records that accumulate and summarize data.
 - (2) Perform tests of the underlying data to verify that the data were accumulated and summarized in accordance with the required or stated criteria and methodology, including the accuracy and completeness of the reports.
 - c. When intervening computations or calculations are required between the records and the reports, trace reported data elements to supporting worksheets or other documentation that link reports to the data.
 - d. Test mathematical accuracy of reports and supporting worksheets.
4. Test the selected reports for completeness.
 - a. For financial reports, review accounting records and ascertain if all applicable accounts were included in the sampled reports (e.g., program income, expenditure credits, loans, and reserve funds).
 - b. For program reports, review the supporting records and ascertain if all applicable data elements were included in the sampled reports.

5. Obtain written representation from management that the reports provided to the auditor are true copies of the reports submitted or electronically transmitted to the awarding agency or pass-through entity in the case of a subrecipient.

14. SPECIAL TESTS AND PROVISIONS

Compliance Requirement – Pursuant to N.C.G.S. §143B-168.12.(c), “The North Carolina Partnership shall require each local partnership to place in each of its contracts a statement...that contractors and subcontractors shall be fidelity bonded, unless the contractors or subcontractors receive less than one hundred thousand dollars (\$100,000) or unless the contract is for child care subsidy services...”.

The specific requirements regarding insurance are found in the provisions of the Smart Start local partnership contract with the DSP.

Audit Objective – Determine that the DSP is complying with the insurance requirements as stated in the contract between the local partnership and DSP.

Suggested Audit Procedures

1. Obtain the contract and review the insurance requirements.
2. Determine whether the DSP is in compliance with these requirements.

Compliance Requirement – All non-State entities that receive, use or expend State funds, including federal funds passed through the N. C. Department of Health and Human Services, are subject to the financial reporting requirements of G. S. 143C-6-23. These requirements include the submission of a written statement that the entity does not have any overdue tax debts as defined by G. S. 105-243.1 at the federal, State or local level (see G. S.143C-6-23.(c)).

The specific requirement regarding no overdue tax debts are found in the provisions of the Smart Start local partnership contract with the DSP.

Audit Objective – Determine that the local partnership has included a provision in the contract between the local partnership and DSP stating that the DSP does not have any overdue tax debts before receiving and disbursing State funds.

Suggested Audit Procedures

1. Obtain the contract and determine that the local partnership has a provision stating that the DSP has no overdue tax debts in accordance with G. S. 143C-6-23.(c).