

DELAWARE STATE FIRE PREVENTION COMMISSION

Statutory Authority: 16 Delaware Code, Section 6603 (16 **Del.C.** §6603)

FINAL

PUBLIC NOTICE

Delaware State Fire Prevention Regulations, Part VIII, Fire Department and Ambulance Company Administrative Standards, Chapter 1 Financial Audit Regulations

Nature of the Proceedings

The State Fire Prevention Commission ("the Commission") held a properly noticed, public hearing on October 21, 2008 to receive comment on new regulations proposed as the result of the enactment of House Bill 329, codified at 16 **Del.C.** §1622, which requires the Commission to establish minimum requirements related to the mandatory submission of financial audits by volunteer fire and ambulance companies. The new regulations will be included as Delaware State Fire Prevention Regulations, Part VIII, Fire Department and Ambulance Company Administrative Standards, Financial Audit Regulations.

Summary of the Evidence

1. The notices of the proposed hearing as published in the News Journal and the Delaware State News were admitted collectively as Exhibit 1.

2. An e-mail dated October 1, 2008 from Renee Villano, CPA, of Grabowski, Sparano and Vincelle, CPAs was admitted as Exhibit 2. In her written submission, Ms. Villano stated that under Regulation 3.0 a "Review" is not a type of audit. She suggested changing the heading to "Report Types" and stating in the regulation that the minimum acceptable report is a "review." She also suggested that the introductory language in Regulation 3.1.1 be changed from "The 'Review' Opinion Letter provided..." to "The 'Accountants' Report' provided to the..."

Finally, Ms. Villano questioned Regulation 3.2 which provides that "a full financial audit may be required...if a company receives a second annual 'review' report that continues to indicate various problems, including a lack of appropriate internal controls." Ms. Villano stated that an accountant is not required to report on or obtain an understanding of a company's internal controls when the accountant performs a "Review." Ms. Villano appended NPO-CR-10: Illustrative Engagement Letter for a Review to her e-mail.

3. An e-mail received from Roland Leathrum dated October 2, 2008 in response to Ms. Villano's comments was admitted as Exhibit 3. Specifically, Mr. Leathrum stated that "there may be as many ways to read Section 3 of the proposed regulation as there are accountants." He also added that he had received a verbal comment from Jon Townley of Control Temp, Inc., who does accounting work for various fire companies. Mr. Townley submitted that the word "certified" should be dropped from paragraph 3.1 because a "review" does not need the services of a CPA.

4. An e-mail received from Allen Methany dated October 2, 2008 in response to Ms. Villano's and Mr. Leathrum's comments was admitted as Exhibit 4. Mr. Methany stated that the purpose of requiring "certified" public accountants was to add increased credibility to the process to satisfy local constituents, municipal and county governments and State Officials. He likened getting an opinion from a certified public accountant to getting an opinion from a lawyer rather than a legal clerk.

Mr. Methany did not have an objection to revising 3.0 to read "Report Types."

He stated, however, that the terminology in the Illustrative Engagement Letter that says the purpose is "to express a limited assurance that there are no material modifications that should be made---" is right on target for what the Commission wants to achieve.

5. Faxed comments from George Kerr of Minquas Fire Company No.1 - Station 23 were admitted as Exhibit 5. Mr. Kerr believed that the language in 3.0 Audit Types should also contain the language "independent certified public accounting firm or public accounting firm" to help keep accounting costs reduced. He did not believe that the word "audit" should be used because volunteer fire companies are not publicly traded stock corporations. He believed that the wording should refer to "Compilation and Review" only because accounting educational seminars recommend using "Compilation and Review" and not "Audit." He also believed that requiring an independent audit would create problems for those fire companies that do not calculate their own depreciation or financial statements. He stated that an independent "Compilation and Review" requires that the accountant not perform any duty other than reviewing the fire company provided financial statements. If the accountant performs and other duties the words "I am not independent" must be in the opinion letter. He believes that the independent "Compilation and Review" should be sufficient otherwise fire companies will have to send the work prepared by the one accountant to another accountant for the independent audit wording resulting in higher accounting costs. Mr. Kerr hoped that if a full financial audit is required that a State of Delaware agency would perform the audit at no expense to the fire company.

Mr. Kerr stated that new accounting procedures "The Standards for Excellence: A Code for the Non-profit Sector (the "Standards")" will be in compliance with the new pieces of Form 990 and will be in effect for non-profits with fiscal years that begin in 2008 to be filed the year 2009. He stated that the new procedures will require a more sophisticated method of accounting.

Mr. Kerr recommended that fire companies that are not using an accounting system or doing their own check writing should be trained to use an accounting program that would provide an accountant with their financial statements for a "Compilation and Review." Doing so would also enable the provision of a financial condition report at any time. He recommended Quick Books Premiere; a user friendly software that has a budget module. The purpose of his suggestion is to keep accounting costs down.

Finally, Mr. Kerr commented that there should be a standard "chart of accounts" to provide accurate costs in each category since all fire companies have the same type of income and expenses. He provided example of how different companies post expenses to different accounts which he believes will make it hard for the Commission or the State of Delaware to be provided with accurate information for grant purposes. Mr. Kerr stated that it is time for fire companies to modernize their accounting systems. He stated that financial data should be kept current and that treasurer reports should be given at monthly meetings to reduce the possibility of anyone taking funds for personal use. He believes all financial data should be disclosed during company meetings to enable officer and board for director monitoring of all funds.

Mr. Kerr concluded by stating that non-profits have an obligation to the public and that the new 990 will allow the public to see whether a non-profit is operating appropriately.

6. Correspondence dated October 13, 2008, from William Santora, CPA, of Santora CPA Group was admitted as Exhibit 6. Mr. Santora stated that certain areas in the proposed regulation are inconsistent with the American Institute of Certified Public Accountants' (AICPA) professional standards that govern the required services. In addition, he stated that the proposed sanctions may not be sufficient to secure compliance by all fire and ambulance companies.

Mr. Santora stated that the first area of concern had to do with the interchangeable use of the terms "Audit" and "Review" in the regulations. Although review is defined in Section 2 of the proposed regulations it is discussed in Section 3 in the context of being a lower-level audit. He expressed concern about possible confusion since the two types of reports are governed by separate professional standards; the Statements on Standards of Accounting and Review Services for reviews and the Statements on Auditing Standards for audits. He recommended clarification in the regulations.

As a second point, Mr. Santora stated that if information is provided in review engagement in accordance with the Statements on Standards of Accounting and Review Services, the Commission may not get the information that appears to be contemplated in Section 3 and Section 3.2 related to the adequacy of financial management and

internal controls, as well as any issues or trends that indicate possible failure of the company. While egregious lapses internal controls might be detected and reported on, other equally important controls might go unnoticed. Also, while the review might identify trends indicating possible future failure, it would not provide the information necessary to assess the underlying management issues causing the possible failure. He suggested that the Commission may wish to consider full audits to achieve the stated objectives in the proposed regulations.

Finally, Mr. Santora questioned the effectiveness of a \$5000 maximum penalty for failure to comply. He noted that some companies may weigh the cost of the audit against the cost of the penalty and pay the penalty rather than complying with the reporting requirements. He believed a more effective penalty might be to withhold all future funding until all compliance requirements have been met.

7. Art Ricker of Citizens Hose Company (CHC), Station 51, stated that he has been the treasurer of CHC for 31 years. He expressed concern about the penalty of \$100 per day and felt that it should be capped at \$1,000 comparable to untimely responses on the pension program. He added that untimely reports may be beyond the control of the company. Mr. Ricker stated that ultimately the penalty is taking money out of the organization's pocket. Instead of a cash penalty he suggested that the Commission consider withholding funding for the companies. He stated that withholding funds is a bigger whip that affects a company's cash flow.

8. Allen Methany spoke in response to Mr. Ricker's comments and stated that the proposed regulations provide for a public hearing. Issues that are beyond a company's control, such as the report not being completed by the accountant on time, could be raised as a defense to the imposition of a penalty. Mr. Methany stated that he supports the regulations.

Findings of Fact

Based upon the evidence received, the Commission finds the following facts to be supported by the evidence.

1. The Commission received written and public comment in regard to the proposed regulations at the public hearing. The public comment was in the nature of clarification rather than opposition to the regulations.

2. The Commission is not persuaded by the public comment that it should allow the reports required by the regulations to be performed by public accountants rather than by certified public accountants. The Commission believes that the having the reports performed by independent certified public accountants adds credibility to the process. The Commission is cognizant of the fact that requiring a certified public accountant to prepare the reports may increase costs; however, the Commission finds that it is in the best interests of the public to require the higher level of expertise where public funds are in issue.

3. The Commission is persuaded by the public comment that the use of the term audit in the regulations needs to be clarified to avoid confusion as to when a full audit is required as opposed to when a review level report is required. The Commission finds that the regulation would be improved by replacing the word "audit" with the word "report" or "reports" in those sections of the regulation referencing the review level report or when referring to submissions generally. The Commission finds that the changes are for clarification only and are, therefore, non-substantive. The changes are indicated in the copy of the Regulations attached this Order as Exhibit A.

4. The Commission is not persuaded it should require full financial audits in lieu of review level reports in all instances. The Commission recognizes that there is an increased cost associated with the full financial audit that may not be warranted in every case. The Commission is satisfied that the proposed regulations adequately address when a full audit will be required. If the Commission finds in the future that the review level reports are not achieving the stated objectives of the law, it may revisit the need for full audits in amendments to the Regulations. The Commission is likewise satisfied that the review level report which provides limited assurance that no material modification is required is not so burdensome that it should allow a compilation which provides no assurance.

4. The Commission appreciates the public comment in support of the withholding of funds from fire and ambulance companies that fail to comply with the reporting requirements. The Commission initially proposed that such a provision be added to the law; however, the final version of the law enacted does not give the Commission authority to direct the withholding of funds available to the fire and ambulance companies subject to these

Regulations. The Commission is satisfied that that regulations as proposed provide a company with an opportunity for a hearing to challenge the imposition of penalties related to circumstances beyond their control.

THE LAW

The State Fire Prevention Commission's rulemaking authority for Financial Audit Regulations is found 16 Del.C. §6622 which provides:

§ 6722 Audits of volunteer fire and ambulance companies.

(a) The State Fire Prevention Commission shall promulgate regulations requiring financial audits of volunteer fire and ambulance companies and the Smyrna and Georgetown American Legion Ambulances and the Mid-Sussex Rescue Squad. The regulations shall include, but not be limited to, specifying the required types of audits, the reporting periods, procedures for reviewing the audits and the processes to be followed in the event a company fails to submit or submits an inadequate audits.

(b) The State Fire Prevention Commission shall have the authority, after a hearing, to impose a civil penalty not to exceed \$100 against any volunteer fire and ambulance companies, the Smyrna and Georgetown American Legion Ambulances and the Mid-Sussex Rescue Squad that fails to comply with any regulation promulgated pursuant to subsection (a) of this section. Each day a violation continues may be deemed a separate offense in the Commission's discretion. However, in no event shall the total penalties exceed \$5,000 per reporting period.

(c) The penalties specified in this section are in addition to and not in lieu of any other penalties provided for under this chapter.

Decision

The Commission hereby adopts the Delaware State Fire Prevention Regulations, Part VIII, Fire Department and Ambulance Company Administrative Standards, Financial Audit Regulations as proposed with the alterations and clarifications noted in this Order. A copy of the Regulations as adopted is attached to this Order as Exhibit A.

SO ORDERED this 17th day of December, 2008.

STATE FIRE PREVENTION COMMISSION

Marvin C. Sharp, Jr., Vice-Chairman
Bob Ricker, Vice-Chairman
Willard (Bill) Betts
Kenneth H. McMahan
Douglas S. Murray, Sr.
David Roberts

Chapter 1 Financial Audit Regulations

1.0 General.

- 1.1 **Purpose.** To establish the minimum requirements related to the mandatory submission of financial audits by volunteer fire and ambulance companies in accordance with the provisions of 16 Del.C. §6622.
- 1.2 **Scope.** These Regulations address the required types of audits, the reporting periods, procedures for reviewing the audits and the processes to be followed in the event a company fails to submit or submits an inadequate audit.

- 1.3 **Application.** These Regulations apply to all volunteer fire and ambulance companies and their approved subsidiaries (e.g. auxiliaries operating under the same tax identification number) in the State of Delaware and the Smyrna and Georgetown American Legion Ambulances and the Mid-Sussex Rescue Squad. These regulations do not apply to independent auxiliary organizations operating under a tax identification number that is separate from the fire or ambulance company's number.

2.0 Definitions.

- 2.1 Review: Financial data analysis that provides less assurance than a full audit, but more than a compilation (which provides no assurance). In a review, an auditor expresses limited assurance that the company's financial statements do not require any material modification for them to be in conformity with the provisions of generally accepted accounting principles ("GAAP"). (Ref. Business Dictionary.com)

3.0 [Audit-Report] Types.

- 3.1 [Audits Reports] must be completed by an independent certified public accounting firm at a minimum "Review" level. The [audit] submission shall include, but not be limited to, the following:
- 3.1.1 The [~~"Review"~~ ~~Opinion Letter~~ **Accountant's Report**] provided to the volunteer fire or ambulance companies by their independent accountant.
- 3.1.2 Financial statements, including:
- 3.1.2.1 Statement of financial position (Balance sheet).
- 3.1.2.2 Statement of revenue and expenses.
- 3.1.2.3 Statement of cash flow.
- 3.1.2.4 Notes to financial statements.
- 3.1.2.5 Letter of observations and/or comments.
- 3.1.2.6 Letter of representation.
- 3.1.3 The required documentation shall be submitted to the Commission with a cover sheet signed off on by the volunteer fire or ambulance company president verifying that he or she has reviewed the submission and all of the items required by subsections 3.1.1 and 3.1.2 are included.
- 3.2 A full financial audit may be required, in the Commission's discretion, if a fire department or ambulance company receives a second annual "Review" report that continues to indicate insufficient corrective actions have been taken to address inadequate financial management, lack of appropriate internal controls, and/or issues or trends that indicate possible financial failure of the company.
- 3.3 A fire department or ambulance company may voluntarily submit a full financial audit rather than a review **[audit level report]** if it chooses to do so.

4.0 [Audit-Reporting] Periods.

- 4.1 Any company whose fiscal year begins on or after January 1, 2009 must file ~~[an audit]~~ no later than six and one-half months after the close of the company's fiscal year. **[Audits Reports]** shall be submitted annually thereafter no later than six and one-half months after the close of the company's fiscal year. The **[audit report]** due date will be calculated by the Commission based on the information provided by the volunteer fire and/or ambulance company as to the close of its fiscal year.
- 4.2 No extensions will be granted except upon a showing of hardship. Requests for a hardship extension must be made in writing prior to the **[audit report]** due date. The request must specify in detail the nature of the hardship. A showing of hardship requires that the lack of compliance with this regulation is due to causes beyond the company's control. The Commission's decision on the extension request shall be final.

5.0 [Audit-Report] Compliance Committee.

- 5.1 The Commission shall appoint ~~[an Audit a Report]~~ **Compliance Committee** to review **[audit]** submissions. The **[Audit Report]** Compliance Committee shall consist of at least of three (3) members

who shall be appointed annually at the January meeting of the Commission. The members of the **[Audit Report]** Compliance Committee shall have a professional background that includes auditing and financial experience.

5.2 The **[Audit Report]** Compliance Committee will review the **[audit report(s)]** for compliance with the regulations and will look for any **[auditor accountant]** comments that indicate inadequate financial management, lack of appropriate internal controls, and/or issues or trends that indicate possible financial failure of the company. The **[Audit Report]** Compliance Committee shall report to the Commission as follows:

5.2.1 **[Audits Reports]** that are approved will be forwarded to the Commission with a recommendation for filing with no further action.

5.2.2 Fire department and ambulance companies that fail to file the mandatory financial **[audits reports]** will be referred to the Commission with a recommendation for a hearing before the Commission for the imposition of civil penalties as provided in 16 **Del.C.** §6622 (b) and any other penalties available under the Chapter.

5.2.3 Any **[audit report]** showing financial irregularities will be referred to the Commission with a summary of the deficiencies and a recommendation for a hearing before the Commission to establish a written corrective action plan and/or the imposition of civil penalties as provided in 16 **Del.C.** §6622 (b) and any other penalties available under the Chapter.

5.3 The **[Audit Report]** Compliance Committee may require the volunteer fire or ambulance company to submit such additional documentation as may be necessary for clarification in order for the **[Audit Report]** Compliance Committee to make a decision as to whether referral to the Commission for further action is warranted. Failure to comply with the **[Audit Report]** Compliance Committee's request for additional documentation will result in referral to the Commission for a hearing.

6.0 [Audit Report] Compliance Hearings.

6.1 The Commission shall schedule a hearing within thirty (30) days of receiving a referral from the **[Audit Report]** Compliance Committee.

6.2 Notice of the time and place of the hearing shall be personally served, or sent by registered mail to the address provided by the fire department or ambulance company at the time of the **[audit report]** submission, with return requested, to the fire department or ambulance company at least twenty (20) days prior to the date fixed for the hearing.

6.3 Hearings will be conducted in accordance with the hearing procedures set forth in Commission Regulations, Part 1, Regulation 1-7.6.

6.4 The fire department or ambulance company that is the subject of the hearing will be provided with a copy of the **[Audit Report]** Compliance Committee's report to the Commission.

7.0 Sanctions for Non-compliance.

7.1 Where the Commission has determined, upon notice and hearing, that a fire department or ambulance company failed to file or has filed incomplete **[reports or]** audits in violation of 16 **Del.C.** §6622, the Commission may impose a civil penalty of \$100 per day beginning on the date the **[report or]** audit was due. Each day a violation continues may be deemed a separate offense in the Commission's discretion resulting in penalties of up to \$5000 per reporting. The civil penalty is in addition to any other penalties provided for in the Chapter.

7.2 Where the Commission has determined, upon notice and hearing, that the **[reports or]** audits of a fire department or ambulance company indicate inadequate financial management, lack of appropriate internal controls, and/or issues or trends that indicate possible financial failure of the company the Commission may require a written corrective action plan. Failure to submit a written corrective action plan may result in the imposition of a civil penalty of \$100 per day. Each day a violation continues may be deemed a separate offense in the Commission's discretion resulting in penalties of up to \$5000 per reporting. The civil penalty is in addition to any other penalties provided for in the Chapter.

7.3 Continued failure to file [reports or] audits or to take corrective action may also result in the Commission referring the fire department or ambulance company to other regulatory agencies for review and possible action under their governing authority, including but not limited to, the Internal Revenue Service, the Delaware Division of Revenue and the State Auditor's Office.

8.0 [Audit] Documents

8.1 [Report and A]udit submissions filed with the Commission may be considered public records under the Freedom of Information Act ("FOIA"). The records will not be released except pursuant to a valid FOIA request or subpoena. The volunteer fire department or ambulance company will be given notice of the request. It will be the responsibility of the volunteer fire department or ambulance company to challenge the request in the appropriate court within the time specified by the Commission in the notice; otherwise, the records will be released.

12 DE Reg. 926 (01/01/09) (Final)