



TESTIMONY TO HOUSE APPROPRIATIONS – GOVERNMENT OPERATIONS DIVISION

HB 1453

2/4/2021

Good morning, Chairman Vigesaa, members of the committee, my name is Joshua Gallion, and I serve as North Dakota's State Auditor.

As you are aware, the State Auditor is a constitutional state official elected by North Dakota citizens. My job is to lead the way in providing truthful, objective, and independent information to you and the citizens of North Dakota and because of that, I am here today to provide testimony opposing House Bill 1453.

**Impact on Other State Agencies**

I would like to begin by explaining the direct workload and financial impact this bill will have on every single state agency. This bill would require every state agency to have its own financial statement audit conducted by our staff. While it sounds simple in theory, I assure you it is anything but that. This bill will have a ripple effect across every area of state and even local government in North Dakota.

For us to do a financial statement audit at each agency, the agency's own accounting staff must prepare financial statements for us to audit. This bill assumes that every single agency has staff with the skills, expertise, and capacity to create financial statements that follow the National General Accepted Accounting Principles (GAAP). This is a very detailed process and requires a significant amount of effort and time. The guidelines are expansive, and many small agencies do not have the time or training to properly prepare these statements by following all [show books] of the guidelines.

The reality is most — if not all — state agencies would rely on the Office of Management and Budget (OMB) and private sector Independent Public Accountant (IPA) firms to prepare these financial statements. Because agencies may have to hire out for this type of work, this could result in unnecessary expenses to the state in contracting these financial statements to private IPA firms. OMB contracts out some of the preparation of the Comprehensive Annual Financial Report (CAFR) because of the complexity it requires — and the amount of human resources it takes to complete this incredibly expansive financial report on time.

If passed, this bill will compound the current problem local governments are experiencing when trying to find a quality auditor to complete their required audits. Currently, we are aware of 40 local governments who need an auditor. In 2008, 128 audit firms were licensed to do government audits in North Dakota. Today, only 14 are conducting government audits. Local governments that currently use an accounting firm may be dropped as clients for larger audits and less travel time compared to these rural local government audit clients. Additionally, there will be a considerable lack of experience and a significant learning curve to prepare financial statements at the agency level. This will result in added

audit costs to the agencies because of errors in reporting and the additional time that will go into the audit. The costs to other state agencies to prepare GASB financial statements and notes disclosures cannot be determined but would be significant. Costs could include additional FTE, intensive training, or outsourcing to accounting firms (if there is capacity). If you haven't already, I encourage this committee to send a fiscal note to the 54 agencies that would be switching to a financial statement audit should this bill pass.

**Impact on the Comprehensive Annual Financial Report (CAFR)**

The CAFR audit is conducted during a three-month window using 6,100 hours of staff time each year — or 12,200 hours a biennium. If this bill would pass, our team would not have time to conduct an audit of this integral report.

The State, through OMB, would need to contract that report out every year to make additional time available for this statewide financial statement audit. The estimated additional cost to the state would be \$1.9 million per biennium.

**Impact on the State Auditor's Office**

Our staff at the Auditor's Office are a responsive and flexible team. They can shift our focus to financial statement audits if that is the desire of the legislative assembly. However, there will be a learning curve for our staff if we shift our training to GAAP and possibly reorganize the office structure. Financial statement audits at the individual agencies would result in considerably more audit work than our current process. This is because financial statement auditing standards have more stringent requirements than performance auditing standards, which we currently follow for our operational audits. Additionally, these audits would take longer because of the materiality threshold. To understand materiality and its impact on the length of an audit, please see the example graphic on page 3.

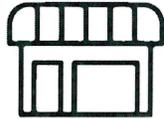
**Estimated Financial Impact on the State Auditor's Office**

	<b>21-23 Biennium</b>	<b>23-25 Biennium</b>
<b>CAFR Cost</b>	1,927,600	1,985,428
<b>Contracted Audit Costs</b>	1,590,241	1,637,948
<b>4 Additional FTE</b>	703,558	712,966
<b>Total</b>	<b>\$4,221,399</b>	<b>\$4,336,342</b>

<b>FTE Cost</b>	
Avg. Monthly Cost	\$4900
Variable Benefits	20.27%
Fixed Benefits	1435.5
Est. Raise	2%

# What is Materiality?

## Example Agency



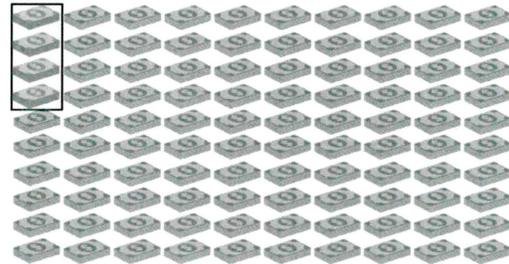
This Example Agency has \$1,000 in total funding. If they have four, \$100 purchases, those are **significant to that agency** and those purchases would require additional review by our auditors.



## State of ND



Example Agency is a part of the State of ND. If the State as a whole has \$10,000 in funding (including the funding from Example Agency) those four purchases from the Example Agency are insignificant to the state as a whole.



**Graphic Explanation:** Example Agency has \$1,000 in total funding. If they have four, \$100 purchases, those are significant to that agency and would require additional review by our auditors. If the State as a whole has \$10,000, these four purchases from Example Agency are insignificant to the state as a whole but are still relevant to that Example Agency. As a whole state, those four \$100 purchases may never be looked at or considered.

In our current process, by following performance auditing standards, we have the flexibility during our biennial operational audits to define the audit breadth, known as the scope. When a performance audit is conducted, there are many additional factors besides materiality that are used in defining scope, such as risk. In financial statement audits, the standards require materiality to drive the entire scope of the audit. This would remove the flexibility that performance audits allow and would require us to do more work, which would ultimately lead to longer audits.

This would result in a higher audit bill, because of a longer audit and an increase in workload for our team. Because these financial statement audits do take more time than some of our operational audits, 4 additional FTE would be needed in the SAO, at an estimated cost of \$703,558 for 21-23 and \$712,966 for 23-25.

### Impact on Contracting Audits

The proposed bill states, "Before entering any contract, the state auditor shall present information to the legislative audit and fiscal review committee on the need for the contract and its estimated cost and duration. The state auditor may charge a state agency for the cost of a contract related to an audit, subject to approval by the legislative assembly or the legislative audit and fiscal review committee if the legislative assembly is not in session."

This is a change in the current process. All the audits that are contracted now are paid directly by the agencies as it is built into their budgets. An estimated continuing appropriation of \$1.6 million with a minimum 3% increase each biennium, would be required to pay for contracted audits of the SAO. These audits are outsourced due to lack of capacity or expertise needed to complete them.

Also, we will not have actual costs for approval until after the request for proposal (RFP) process is complete. This would require more frequent LAFRC meetings in order to meet audit deadlines.

### Closing Comments

Mr. Chairman, members of the committee, this bill would cause a systemic change for nearly every single agency. It could also negatively affect the state's bond rating. If an agency cannot prepare their own financial statements, and cannot find a private firm to assist them, we may have to issue a modified opinion. This could result in a modified opinion of the statewide CAFR which directly impacts our bond rating.

It is incorrect to think we can flip a dial and go back to the way audits were done twenty years ago. The complexity of auditing, accounting, and reporting standards have increased over the past twenty years. Also, twenty years ago, the state's budget was not where it is today. DHS's budget alone grew by 300% since 2000 and we have nearly the same amount of staff as we did 20 years ago. Twenty years ago, was before the implementation of GASB 34 (2009) which made significant changes to financial reporting requirements.

To put this into perspective for you, we would still have found the issues at Commerce during a financial statement audit. Procurement and contract issues would still be found in financial statement audits, and they do on our local government side. The difference you would see in our audits would be in some of our operational areas such as the crime lab audit at the Attorney General's office where we looked at turnaround time on the lab testing or the DOCR audit where we looked at best practices, efficiency and effectiveness of their collection of supervision fees.

I ask that you consider the main points I've shared with you today and I'm happy to stand for any questions you may have.

STATE AUDITOR  
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February 2, 2021

Representative Kasper,

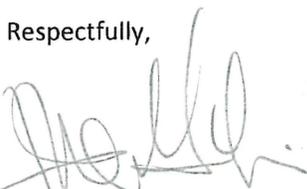
Per your request, below is a timeline of the Belcourt Public School District audit completed by our team in April of 2020.

State Auditor's Office Timeline of Belcourt PSD Audit

- January 19<sup>th</sup>, 2019 – Petition Notarized.
- Week of January 21<sup>st</sup>, 2019 – Petition received by State Auditor's Office.
- January 30<sup>th</sup>, 2019 – Attorney General issues letter in consultation with Secretary of State that petition is valid, and that audit may proceed.
- February 7<sup>th</sup>, 2019 – Met with petitioners over concerns.
- February 22<sup>nd</sup>, 2019 – Engagement letter sent.
- Beginning of April 2019 – Interim fieldwork completed.
- The Belcourt PSD had a June 30, 2019, audit period so nothing further could be done until after that date. The federal fiscal cycle ended September 30, 2019. Because of the Single Audit (federal) component, we had to wait until the end of that period as well.
- October 2019 – Belcourt PSD ready for us to come back to finish field work.
- October 2019-March 2020 – This period was used to finish the audit. Due to number of significant findings (15) and the work that goes into each one and that we had to wait on the prior auditor getting information to the client for us to complete necessary portions of our audit work.
- March 23<sup>rd</sup>, 2020 – Client requested extension for action plan. We granted it and extended it to April 10<sup>th</sup>.
- April 13<sup>th</sup>, 2020 – Audit report issue date.

If you have any questions about the timeline, please feel free to call me at 701-595-2069.

Respectfully,



Joshua C. Gallion  
North Dakota State Auditor