



Budget Bill Testimony

2023-2025 Legislative Session - Government Operations Division

January 19, 2023

Good morning, Chairman Wanzek, members of the committee, my name is Joshua Gallion, and I have the honor of serving as North Dakota's State Auditor. I'm here today to discuss how the State Auditor's Office can better serve our state and provide information regarding our efforts to fulfill our statutory obligations while improving accountability and promoting transparency of state and local governments, and institutions of higher education.

We're going to go through the outline as requested by the committee. Feel free to stop me along the way and ask questions.

[slide 2] N.D.C.C. Major Responsibilities

The Tennessee Comptroller's Office called our office "small but mighty" and I think that sums up our chapter of Century Code nicely. It's small but it touches nearly every government entity in the state and covers a tremendous amount of responsibility that our team of 61 manages.

[slide 3] Purpose of the Five Divisions

The Agency Division is the largest division and is responsible for auditing state government and conducts financial, compliance, performance and information systems audits.

The Local Government Division performs audits of counties, cities, school districts and other political subdivisions. This division also conducts petition audits and provides non-auditing services such as review of annual financial statements, and audit reports completed by independent accounting firms.

The North Dakota University System Performance Division conducts performance and financial audits of the North Dakota University System's 11 different colleges and universities.

The Mineral Royalty Division conducts compliance reviews and audits of federal royalty payments from oil, gas and coal leases located within the State of North Dakota. This division is fully funded by the federal government.

The Operations Division works to ensure the efficient performance of all the divisions within the agency. The division consists of information technology, accounting, administrative assistants, communications, quality assurance, and others.

[slide 4] Organization Chart

You'll see our organization chart maybe looks different than others you've seen. I believe I am the least important person on the team, that's why I am at the bottom. The most important are the citizens we work for and the staff who do the day-to-day work. That's why our organization chart is flipped upside down. The teal represents interns, the dark blue represents a Bismarck team member and the red is a Fargo team member.

As of January 1, we had one vacancy in the agency division. Since then, we've lost a ten-year employee to a good opportunity for him with a salary we couldn't compete with. The other position in the agency division I'd like to point you too is the "position filled". This position will be filled upon graduation with one of our interns. The

vacancy in the column 2nd from the right is in our mineral royalty position that we plan to fill in the next few months either with an intern or FTE. The last column is our local government column. These vacancies are due to turnover.

[slide 5] **Audit Results**

Everyone wants to know who audits the auditor. We get two audits done. One by NSAA known as the Peer Review and one done by Eide Bailly. The most recent audit was procured by Legislative Council and conducted by Eide Bailly LLP for fiscal years 2020 and 2021.

A finding and adjustment were reported. The finding included a prior period adjustment from fiscal year 2019 of \$54,862 where salaries were paid from the special fund operating account, instead of the general fund. An entry was completed after the close of fiscal year 2019 to correct the incorrect payment.

The second item included in the finding related to accounts receivable and was caused by human error when reporting the numbers to Eide Bailly. Both items included in the adjustment were identified by the SAO and corrected by the office. The SAO has implemented steps to prevent transactions posting to the incorrect fund and will complete timely reconciliations of all accounts prior to future audits.

[slide 6] **Biennium Accomplishments**

We held our first ever virtual audit summit for local governments. Our staff spoke on topics like the budgeting process, law changes that impact local governments, CARES funding and the Single Audit, how to understand an audit report, and more. We were hoping for 100 attendees and ended up with 320 virtual attendees. Our recorded sessions continue to reach attendees and have had a total of nearly 40 hours in re-watched breakout sessions.

We hired 17 interns this biennium and extended offers to six of them. Interns have been the answer to our talent pipeline issue.

Federal funding has increased by 51% in North Dakota thanks to ARPA and CARES funding. Our team is currently finishing up one of the largest Single Audit's our office has ever completed.

We reorganized our office to better serve local governments with the expansion of our Quality Assurance team.

We've implemented Microsoft Dynamics to better track the 2,000 local governments we serve.

[slide 7] **Biennium Challenges**

Petition audits create a lot of unknowns and can throw our entire calendar year of planned audits out the window. For example, the recent Williston Public Schools district audit was a 1,000-hour audit that was not planned for. This causes us to push back some audits or switch some audits from one to two years to fit in the petition audits into our schedule. It's hard to plan for these and we're unsure how many we'll have at any given time. We're working through four petition audits right now and we know of 2 circulating petitions.

The 2018 Yellowbook states that preparing the financial statements in their entirety creates a significant threat to auditor independence and that should be reduced to an acceptable level by safeguards. How it works right now is a lot of these small audit shops in the state prepare both the financial statements and then audit them. We've been able to separate the two with a larger team like ours but how this independence requirement will effect private firms in North Dakota remains to be seen. They're going to have to find a solution that allows them to rely on someone else to prepare the financials or do the audit, they won't be able to do both for much longer.

I'm sure this is a statement you are hearing often in these hearings, but keeping our qualified staff continues to prove to be difficult. We recently lost a 10-year employee who was offered over \$2,000 more a month than what we could pay. We can't compete with that without creating major equity issues across our agency.

Training and education to these local governments will continue to be a challenge.

[slide 8] **Next Biennium Goals**

[slide 9] **23-25 Requests Compared to Current Biennium**

[slide 10] **14 Special Funded FTE**

There is a continued need for more local government auditors. We were fortunate enough to get eight last legislative session and I am happy to report that we've filled them all within the first 16 months of the biennium. We're now back asking for additional resources in our attempt to meet the demands of local government audit services.

We have testified in the past that the number of private firms conducting local government audits in North Dakota is shrinking. There are now 11 firms, three fewer than in the previous biennium who are still conducting these audits. Of those 11, 2 firms have dropped 22 clients since last session citing workforce issues

Those 22 clients plus another 21 local governments we're aware of that have been dropped by three firms leaving the industry equals 43 local governments without auditors. It would take 7 FTE to audit them all.

The 11 firms remaining have 631 outstanding audit reports that are owed to our office and are now considered delinquent.

Our wait list has now grown to 45 local governments & it would take 8 FTE to audit them all.

- Averaging 14 extended reviews per year (over last 3 years) which takes 1 FTE

SB 2180 will allow us to move some local governments to annual reviews of their yearly financials rather than a full-blown audit. Moving 120 local governments from audits to extended reviews will take 4 FTE. This will result in a substantial cost savings to these local governments when your average audit costs \$17,500 and a review averages \$1,500. This bill will result in \$2.1 million per biennium in savings for local governments.

[slide 11] **General Funded FTE**

The Attorney Position

Audits routinely and frequently involve North Dakota Century Code and the Auditor's Office looks for agency compliance. Presently the Auditor's Office must contact the Attorney General's office to obtain an opinion or interpretation of N.D.C.C., or to assist in interpreting legislative intent. The current arrangement can be time-consuming. For example, Labor Commission is only planned and budgeted for two weeks of time for our team, from start to finish. When we need assistance from the AG's Office, that can extend the completion of our audit by weeks that we simply do not have because we're already scheduled to move on to another engagement.

We're often left in conflicts, most recently evident by our investigation of the Attorney General building lease. We found ourselves needing answers to legal questions with nowhere to turn and no time to procure any outside legal advice under our 90-day deadline. We're now on our 3rd SAAG in the past 4 years and we must start over educating this person on auditing standards and our section of code.

Each SAAG assigned to state agencies has a portfolio. They have dozens of agencies, boards and commissions they represent. Our SAAG is not unlike any other. However, we audit all state agencies and some boards and commissions. That creates a conflict of interest. When our SAAG represents the client AND us, we have to wait and get assigned another attorney for the audit who is completely unfamiliar with auditing standards and our Chapter of N.D.C.C.

[slide 12] **Four General Funded Auditors**

We're asking that you restore the one general funded full-time position that was taken last session and add an additional three to accommodate the 51% increase in federal funding that needs to be audited under the Federal Single Audit. As a reminder, we do bill the federal government for work done under this audit so portions of those salaries will be recouped. In 19-20, the Single Audit audited \$4.4 billion. Compared to 21-22 its jumped to \$6.7 billion, and we will continue to see this funding until 2026. This has resulted in over 760 hours of overtime with more expected in quarter 1 of 2023.

With the combining of Health and Human Services this past session, the time has come for us to have a constant presence in HHS due to the complexity of the agency, the breadth of programs, and the increased risk in joining two agencies fiscal practices into one.

[slide 13] **Training and Education Coordinator**

The final general funded position we're asking for is an education and training coordinator.

Since I took office, we've seen an increase in the demand for education and training for the local government officials that we interact with daily. Unlike the state agencies that we work with, most of these local governments don't have trained accountants managing their books. Some are part time and even volunteers.

Government accounting and auditing standards are ever changing and are becoming more and more stringent in their requirements and these local governments don't have the resources to educate their staff on these requirements.

We've found through a little education, these entities better understand the accounting standards they need to follow, how the Auditor's Office can be helpful, and ultimately what necessary steps they need to take to ensure financial accountability to their citizens.

Education assists in speeding up audits, thus reducing audit costs and allowing us to serve more clients with the same number of staff. To emphasize this issue, I'd like to share a little fact, 92% of the cities who submitted annual financial reports to our office had a finding throughout the course of their annual review. With the right education and training, and of course participation, this number should drop substantially.

Up to this point, we have tried to take on these added responsibilities in addition to our already full workload of doing actual audits. This person would solely focus on education and training for these local governments by producing resources, tools, webinars, videos, etc.

Of the 770 reviews done this biennium, 447 of them or 58% had a finding. This means they needed help completing their financial report correctly. Of those 770, 205 were cities & 188 (92%) had a finding.

There were 13 new accounting/auditing standards that came out this past biennium with at least 10 more new accounting/auditing standards planned to come out this next biennium. That's difficult to be able to keep up with

them and understand how to implement them when you have staff wearing many hats in these local governments or even volunteering.

[slide 14] **Temporary Salary Line**

I am proud to say that the Auditor's Office doesn't have a recruitment issue. In fact, our strong internship program has been our main talent pipeline for filling vacant full-time positions. Since 2018, we've hired 30 interns and have filled FTE vacancies with 12 of them. Our internship program is keeping North Dakota students right here in North Dakota upon graduation. We currently have ten interns on staff and are the second largest internship program behind the NDDOT.

Our local government team is responsible for reviewing 2000 annual financial reports every calendar year under the direction of full-time staff. This business function relies on interns being able to help process and review these while the full-time staff focus primarily on audits. Without these interns to do this work we would have to have additional FTE to do it and, as you know, that comes at a higher price for the taxpayers.

Up to this point, we've used excess salary fund dollars to fund our internship program. What we've found is when we cross biennium's, we can find ourselves in a situation where we are fully-staffed and may not have dollars to support our talent pipeline of interns.

[slide 15] **Equity Package**

In the United States, there's been a 17% decline in accountants and auditors leaving their jobs in the past two years, and the number of college students coming into the field can't fill the gap. The North Dakota University System and private colleges combined are graduating less than 250 students per year while the number of job openings for accountants and auditors is exceeding 400+ per year. Once we recruit these students into these positions, we must have the means to keep their salaries competitive in order to retain them.

The SAO realizes the world is changing rapidly and our legislative increases are not keeping up with inflation and cost of living. In addition, the salary gap with private business has made it tough to retain current staff and recruit experienced ones. Data provided by the North Dakota Labor Market Information from 2021 supports the office's request and shows employees under five years of service

[slide 16] **Training and Development Inflationary Increase**

With the recent inflationary increases, travel and professional development costs have increased drastically and there is a need for additional operating money to continue auditing and training at current levels.

Government auditors are required to have 80 hours of continuing professional education every two years. To achieve this, we attend conferences, participate in webinars, and use online subscription based professional development platforms to adhere to the requirement.

[slide 17] **TeamMate Upgrade**

The IT system the Auditor's Office uses for its electronic working papers, a system which is essential to each audit, has end of life approaching and will require an upgrade to TeamMate +. End of life was originally December 2023 but has been pushed back a bit due to COVID, but expectations are our current version will have no support soon.

This is the primary software used by our audit teams to conduct their audits and our auditors spend 80% of their day in TeamMate. Other agencies, such as BND, DOT, and Trust Lands have already migrated, but do not have the level of use the SAO does with the software.

As you know with software, you can't just flip on a switch, so we are looking to migrate to TeamMate + now, to avoid any issues in the near future. The \$40,950 cost provided as a one-time migration cost would intend to cover all the migration of past projects and audits in TeamMate AM to TeamMate +.

[slide 18] **Dickinson Office**

Many local government clients in Western North Dakota are struggling to find an auditor to conduct their audits. Some private firms are removing themselves from the government auditing field due to differing reasons, but this is leaving local governments in a tough spot. Opening a Dickinson office would allow the SAO to be closer to clients and assist these clients face-to-face. 27 of the 45 on our waiting list, or 60%, are from the western part of the state.

The only businesses serving clients out west are either coming from Bismarck or Montana.

[slide 19] **Funding for Each Program/Line Item**

[slide 20] **Current Biennium One-Time Finding**

As with anything these days, market prices are going up. If you'd like the IT Security Review to cover the same amount of areas they have looked at previously, we'd need to see an increase in that funding. We've requested updated numbers from the current contractor so you can see the increase. For the same amount of hours, their cost would go up to around \$465,000.

[slide 21] **Deposits into General Fund**

No significant changes are anticipated to revenue collections for the state agency division unless legislation is passed to change the billing method of the office. Amounts can fluctuate slightly for the NDUS Financial Statement Audits or Federal Single Audit if more or less hours are required.

- The state auditor deposits money into the general fund for the above-mentioned services. Estimated collections for audits conducted by the state agency division:
 - Agency Audits - \$690,000
 - University Systems Financial Statement Audits - \$515,000
 - Federal Single Audit - \$1,300,000

[slide 22] **Deposits into Special Fund – operate like a small business**

Biennium to date revenue: \$2,625,444

[slide 23] **Other Bills Effecting the State Auditor's Office**

[slide 24] **One-pager - Changes to the Executive Budget**

[slide 25] **Comparison of Major Request to Executive Budget Table**

[slide 26] **Federal Funding – Ryan Bauer, CPA, Audit Manager**

The State Auditor's Office has one federal fund awarded by the Department of the Interior (DOI) and the Office of Natural Resources Revenue (ONRR). A new three-year cooperative agreement was recently signed for the period 10/01/2022 - 09/30/2025. There is an option to renew the contract for another three-year period through 09/30/2028.

The group conducts audits and investigations related to oil and gas revenues owed to the United States and shared with the State, which are attributable to leased Federal onshore property within the State.

Funding for future fiscal years is contingent upon appropriation by Congress and an exact amount cannot be determined.

The division operates on a reimbursement basis. Each quarter, necessary reports are provided to the feds and a reimbursement is requested.

[slide 27] **Questions**

This concludes my testimony and I'm happy to answer any questions you may have. Thank you.