



HB 1508

2023-2025 Legislative Session

Senate State and Local
March 17, 2023

Hello, Madam Chair Roers and members of the committee for the record my name is Lindsey Slappy. I am an Audit Manager at the Auditor's Office. I have been with the office for almost 13 years and am a Certified Public Accountant (CPA). I'm going to walk you through each section of the proposed amendment that has a negative impact on the Auditor's Office. If you want to follow along, I'm looking at the amendment proposed during last week's hearing by Representative O'Brien.

Section 1 (page. 1, line 11)

This section requires all employees to get a background check. This section is unnecessary. This is already common practice for us per OMB and their required HR Policy 112 to gain access to PeopleSoft. This policy already refers to N.D.C.C. 12-60-24. The background checks are done through BCI. We also undergo additional background checks, if required by the client. For example, the Tax Department has requested team members whose background check wasn't within the last 10 years to complete a new background check. We have also completed additional agreements for various entity's based on their own requirements. For example, we sign a secrecy agreement and watch a video on federal tax information confidentiality annually. Any additional agreements related to FERPA, HIPPA, and other provisions would be signed as necessary after consultation with our legal representative from the Attorney General's Office.

During Friday's hearing, there was a question about a HIPPA agreement for the Kildeer Area Ambulance. I consulted with the audit manager of this audit. We received guidance from the Attorney General's office that the HIPPA agreement was not necessary. The audit team did not review private health information as part of the audit.

Section 3 (page 2, lines 26-28)

This particular section 54-10-01(c) relates only to state agency audits. The way this addition is written, we couldn't charge for audit work if the lead auditor was new to the audit or had less than two years of experience. We read this as a CPA who has 24 years of experience with our office wouldn't be able to charge for an audit if they were the lead auditor and had never been on that particular audit. The billing on the state agency side is deposited directly into the general fund for appropriation by the legislature. If the legislature would like us to stop billing for these two-year state agency audits, that would result in less funds being deposited into the general fund. Our office doesn't have an issue with not billing these state agencies for these two-year audits. Our current practice is based on Century Code.

We are unclear how this would impact our Federal Single Audit billing. This audit includes a variety of federal programs which are assigned to individual staff members for completion. Would we be unable to bill if the person completing this program did not have two years of experience or experience with that specific program? There were several brand new federal programs as a result of the COVID-19 pandemic which no one would have prior experience. We potentially couldn't bill the federal program for work completed by a senior level staff member.

Section 3 (page 3, lines 21-23)

We're not sure what the intention is with this section. Is it to remove the ability to do all performance audits? Our current post-audits done under 54-10-01(c) are conducted under the government auditing standards for performance audits. If that was the case, and those audits now had to be financial audits, this would have a tremendous financial impact on state agencies.

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. That's assuming that every single agency has staff with the skills, expertise, and capacity to create financial statements that follow Generally 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 agencies do not have the time or training to properly prepare these statements by following all the guidelines.

Section 3 #3 (page 4, lines 14-15)

This is the only section in the original bill as it came over from the House. This has little impact on our office. We currently have CPAs review and approve our financial audits.

Section 3 #4 (page 4, lines 16-18)

This is a redundancy as its already mentioned in 54-10-14(4) that "the state auditor shall review the audit report to determine if the report is in the required form and has the required content, and if the audit meets generally accepted auditing standards."

There is a misunderstanding happening with the word rejection. When a rejection letter goes out, its more of a correction letter. We outline what standards were not met and request that they fix the errors and then resubmit for another review. Most firms that receive rejection letters have a few errors that they fix, send back and they are accepted once they meet the standards. Our office would not require a whole new audit.

In previous testimony made, it has been inferred that because you have a CPA license, you meet generally accepted auditing standards. That is simply not true. With the standards, that can change annually, the purpose of reviews of outside audits is to ensure the consistency of information provided to the user of the report. Ultimately, all government audits are done on behalf of the State Auditor's Office, so this process is important to us.

Section 3 #5 (page 4, lines 19-22)

We're unsure what an audit template means. The American Institute of Certified Public Accountants (AICPA) publishes guides that can be purchased. These guides include specific guidance for audit opinions and reports on internal control and compliance that are used based on the circumstance of

your audit. These guides also provide additional guidance on various elements of auditing standards. There are additional tools that can be purchased through Thomson Reuters and other similar companies that can be used throughout the audit.

Audits are customized based on the client. There are a variety of factors that determine the work needed and how the information should be reported. This includes reporting framework (modified cash, GAAP), types of funds, component units, etc.

There is not a one-size fits all audit template that the Auditor's Office can compile. This is simply not possible.

Section 3 #6 (page 4, lines 23-29)

This section added additional requirements to be included in each audit report.

In this last interim, the [Legislative and Audit Fiscal Review Committee](#) worked in consultation with our office and the private firms to remove the 14 communication questions from the audit reports and instead, provide an executive summary outside of the audit report for audit periods ending on June 30, 2022. The committee members voted unanimously to make this change after discussion at multiple meetings. There are two separate executive summaries that will be used, one for performance audits and one for financial audits. These executive summaries will be provided for the first time for audits heard during the 2nd quarter 2023 LAFRC meeting. Currently, the information in A, B, and C are being included in the reports.

- A- A summary of the audit conducted-All performance audits included a highlights page which is a high-level overview of the audit. All financial audits follow the form and content required by the AICPA.
- B- Disclosure of any disagreements with management-Financial auditing standards already require disagreements with management to be disclosed in the governance communication which is a required communication for the audit. Also, any client disagreements with audit findings for performance and financial audits would be included in the entity's response.
- C- Any findings and whether the findings were addressed or corrected-Auditing standards for both performance and financial audits require that audit findings are reported within the audit reports. We are also required to receive a response or corrective action from the auditee to include with the audit recommendation. An audit addresses the circumstances that occurred during the audit period; therefore, the auditor's office cannot provide feedback on whether a finding was addressed. An audit addresses the circumstances that occurred during the audit period. Audit recommendations would be evaluated in subsequent audit periods to determine whether they were implemented.

54-10-13 (page 5, lines 4-5)

This section removes our ability to call for an audit based on alleged improprieties. This would prevent us from conducting an audit if we're made aware of fraud, waste or abuse.

Section 7 54-10-25(3) (page 6, lines 3)

This section creates a criminal penalty for divulging information.

We take confidentiality seriously in the Auditor's office. We train all new staff on confidentiality. Our office utilizes guidelines compiled by the Attorney General's Office that identifies various types of confidential information. We also ask our clients to identify if any information provided contains confidential information. If we have any confidential documents, we lock it in our electronic workpapers, so only the people on the audit team can access the document. We also make efforts to remove confidential information from files if it is not needed in our audit.

A question was asked last week about the types of audits and the confidential aspects of those. Our office completes both performance and financial audits of state agencies, colleges, and universities. These audits may contain a variety of confidential information such as social security numbers, bank information, employee information, HIPPA, FERPA, and federal tax information. As I discussed previously, our office signs necessary confidentiality agreements, receives background checks, and follows procedures to lock confidential information within working papers.

Our office also completes financial audits of political subdivisions. These audits may have confidential information such as bank information and employee information.

This section is a response to an instance that claims confidential information had been provided by an employee in our office. At the end of my presentation, Josh will discuss this specific email more in depth.

Section 8 (page 6, lines 29)

This section prevents us from requesting workpapers. We have several major concerns with this section.

First, I would like to just provide the background on what are working papers. Working papers are the documents contained within an audit that demonstrate the work an auditor completed to get to their final conclusions. There are several instances when preventing the ability to access these working papers could prevent our office from doing our job.

1. Our office contracts with private firms to complete audits of State Agencies. As part of this process, we prepare a request for proposal that outlines the scope of work that needs to be completed. There are times we will request working papers to ensure that the scope of work in the contract was fulfilled. This has even been done at the request of the state agency being audited by a private firm. This section of code would prevent us from gaining that assurance that a private firm met the scope of work requirements for a contract with the state.
2. Our office takes on new clients that we did not previously audit. As part of the auditing standards, we are required to do work to ensure the beginning balances are accurate. Beginning balances are the ending balances from the prior auditor's working papers. The auditing standards allow us to review the working papers of the prior auditor to gain assurance on these balances. If we are not allowed to do this, it would require additional audit procedures for any new clients. Additional procedures would result in additional hours to the audit increasing the audit bill.
3. Under N.D.C.C. 26.1-21-12, our office is responsible for reviewing the claims filed with the North Dakota Insurance Reserve Fund for the State Bonding Fund. Throughout our review, we may identify that an external audit was completed and would relate to the incident in the Bonding fund claim. This proposed language would prevent us from getting access to the working papers

from the firm. This would result in our team needing to do additional work. Additional work again results in additional hours and costs.

4. Our office may require testing of specific laws at political subdivisions to ensure consistency between all firms and our office. For example, we require the budget to be tested for all County audits. In order to verify this is being included, we request the working papers related to that law testing. This section would prevent us from getting that verification.
5. Our office reviews all audit reports submitted for political subdivisions. During our review process, we may identify that the report appears to not follow auditing standards. We may request working papers to ensure something is completed. We would no longer be able to complete this type of verification.

Section 9 (page 7, lines 1-5)

This section requires us to give “state entities, political subdivisions or occupational boards or professional boards 30 days to review findings before the office publishes the auditing findings.”

I want clarify our process for communicating audit findings to our clients. All audit findings are provided to the client prior to the completion of the audit. It is important to note that auditing standards require us to receive finding responses or corrective actions for all auditing findings. As you can see from reports posted on our website, the reports that contain auditing findings have a response from the auditee. The easiest way to explain this is to walk through an example.

This is the process we follow for our performance audits:

1. The audit team would identify errors during the audit process and communicate with the client.
2. The audit team would draft the audit findings as part of the audit report.
3. The draft audit report is provided to the auditee. The auditee is given two weeks to review and respond to the audit findings. During this time, the auditee has the ability to suggest potential wording changes and provide their response for inclusion in the audit. I want to make it clear that the two-week time is a guideline. It is not a firm deadline. We work with the client if this time is unreasonable to them.
4. The response is added to the audit report and the report is almost ready to finalize.
5. The audit report which includes the audit findings and responses is provided to the Legislative Audit and Fiscal Review Committee (LAFRC) for seven days. This was a change from HB 1453 from last session.
6. After this 7-day period, the audit is finalized. It is considered a public document and is uploaded to our website.

The process followed for financial audits is similar the one I just discussed. The main difference is these audits are not provided to the LAFRC committee for review. This step was not included as part of previous legislation due to the finalization time requirements for financial audits. The other difference is audit findings in financial audits may be included in a separate email or document rather than the draft audit report. The final steps include providing a final copy to the client, posting the report to our website and issuing a press release when necessary. By the time a report is posted to our website or a press release is issued, the client has already reviewed and approved the report as well as provided responses.

Now that I have outlined the process, I want to discuss some of the concerns with this section.

This section requires our office to provide the audit findings 30 days prior to publishing the audit findings. This could create problems for financial audits. First, many political subdivision clients have deadlines for receiving their final report. They provide their response quickly and need their final report. The language in this section does not provide any flexibility to meet the clients needs and provide quick turnaround at their request.

Next, auditing standards require financial audits to be finalized within 60 days of completion. The timing of completing the audit, providing the audit findings, including the 30 day period, and completing the audit may cause us to not meet the audit standards.

The next area of discussion is an area of uncertainty for our office. The language in this section requires our office to provide all audit findings to the LAFRC. It's not been common practice to report to the Legislative Audit and Fiscal Review Committee on political subdivisions. Is it the wishes of the committee to now hear reports on political subdivisions? How would findings from private firms be presented? Our office only completes around 15% of the local government audits. This would mean that LAFRC could now be hearing up to an additional 400 audit reports annually from the private firms who conduct local government audits. On the state agency side, the firms include in their cost proposals the time to come to the LAFRC and present the reports. Currently, LAFRC meets one day a quarter. This may need to increase to address the additional audits of political subdivisions.

Section 10 (page 7, lines 8-12)

As mentioned previously, this is already common practice for our agency. Every single employee, including temps and interns has a background check completed.

Section 11 (page 7, lines 15-17)

This section does not allow our office to increase audit costs beyond the cost of the engagement letter. There has been a lot of discussion on the billing of political subdivisions and our records of the amount charged to these entities.

It is not common practice for us to include a proposed audit cost in the engagement letter unless it is specifically requested from the client. As a reminder, the division that completes these audits is fully special funded. There has been a lot of discussion on the fees and the fact that our office receives an appropriation for these special funds. It is correct that we do receive an appropriation. However, it is important to note that a special fund appropriation does not provide any actual dollars to our office. It only gives us spending authority for the money we collect in audit fees. If the legislature gives our special fund the ability to spend \$5 million dollars and we only collect \$3 million in audit fees. We will only be able to spend \$3 million because the legislature does not give physical dollars. This is very different than general fund appropriation which provides physical dollars and the ability to spend them.

This section of law prohibits the ability to increase an audit bill above a proposed cost. That can create a problem. There are times that you would give a proposal and the scope of work may be different than originally thought. For example, the entity may have far more federal funding and federal programs than we realized. We would have to follow Single Audit guidelines for program selection, sampling etc. This would be additional work that was not initially planned for but based on this language we would not be

able to recover those costs. Since this division is special funded, how would we pay for the staff that completed this work? I can equate this to the Bank of North Dakota audit. We have allowed amendments because additional loan programs have been added through the legislative process which results in additional work.

There was a question last week related to the itemizing of audit bills. Our billing has always been based on actual hours put into a project and the billing rate for the individuals completing the work. For each audit, all members of the team complete timesheets in our electronic working papers software. Each audit has its own project. When the audit is completed, the billing amount is calculated based on those hours charged. This amount is summarized and provided on the bill.

Section 12 (page 7, lines 20-25)

The special state auditor was a topic addressed in the last legislative session and that section of code was repealed since it had not been used since it was put into law in 1967.

Some of the questions we have about this section of code:

- With all the “same power and authority” as the State Auditor, would the Special State Auditor have access to employees, office equipment, software and confidential information within that State Auditor’s Office?
- Who pays for this special state auditor?
- Could the Special State Auditor issue audit reports to steer an outcome whether positive or negative?
- There is no clear requirement to hire a private firm. Could this person be a current state employee?
- Results of Audits are reported to the Governor instead of the Legislature or LAFRC
- How long would this person have the “same power and authority”? During one audit? For a certain length of time? Ongoing?
- The person or firm may not have received a peer-review as required by Government Auditing Standards
- Would the work of this Special State Auditor become part of our peer review and potential impact our rating from NASACT?
- Do they have the same Continuing Professional Education credits as required to be a government auditor?

Those conclude my comments on the amendment, and I’ll stand for any questions before I turn it over to Josh.