



HB1004 - Budget Bill Testimony

2025-2027 Legislative Session – House Government Operations Division

January 14, 2025

Good morning, Chairman Monson, 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 State Auditor's Office touches nearly every government in our state, whether that be small local governments or large state agencies, or even federal dollars being passed through our state agencies. Our team is dedicated to providing independent information to the citizens of North Dakota to inspire action.

[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, the Office of Good Government and others.

[slide 4] Organization Chart

I believe the most important aspect of what we do is serving the State of North Dakota, which is why they are listed first, at the top. The staff that support our mission on the front lines, who interact with our clients on a daily basis are directly below the citizens, followed by our Senior Staff, and then me at the very bottom. I view my role in leading the organization is making sure that every member of our team has the resources and ability to best serve the state. The teal represents interns, the dark blue represents a Bismarck team member and the red is a Fargo team member.

[slide 5] **Audit Results**

Everyone wants to know who audits the auditor. We get two audits done. The first is done by the National State Auditor's Association, known as the Peer Review. The peer review is completed by a group of experienced auditors from across the country. Each member of the team must be recommended by their home state and is assigned to the team based on expertise by the National State Auditor's Association. The purpose of the peer review is to conclude on our system of quality control. It ensures our team maintains Independence, meets Continuing Professional Education requirements, and adheres to both our own internal policies and auditing requirements published by the GAO and AICPA.

This review includes the following:

- An evaluation of our level of expertise to ensure reasonableness.
- Evaluation of our independence assessment procedures.
- Sampling of independence assessments for engagements to ensure independence is maintained.
- Evaluation of the Office Policy and Procedures Manual to ensure all required policies & procedures have been developed.
- Review of Continuing Professional Education completed by staff to ensure GAO CPE requirements have been met.
- Sample of completed engagements to ensure each engagement met auditing standards established by the GAO and AICPA.
- The Peer Review looks at all our audits including performance, financial and the Single Audit.

The second audit we receive is a financial audit. The most recent audit was procured by Legislative Council and conducted by Eide Bailly LLP for fiscal years 2022 and 2023.

There were no findings in either of these audits.

[slide 6] **Biennium Accomplishments**

We held our third annual virtual audit summit for local governments. Our staff spoke on topics like the budgeting process, law changes that impact local governments, the Single Audit, upcoming standards changes that will impact them, and more. We continue year after year of having over 300 virtual attendees. Our recorded sessions continue to reach attendees and have had a total of nearly 140 hours in re-watched breakout sessions.

Our team is committed to continuous improvement. The audit of the state's Annual Comprehensive Financial Report took our team about 4500 hours to complete. This is attributed to our project management strategy and staff working over the past two years to evaluate new standards and streamline some of our processes. This has allowed us to maintain our continued workload.

Thanks to our project management strategy, we were able to find internal efficiencies and time savings, allowing us to reorganized our office to better serve local governments with the expansion of our Quality Assurance team. It has allowed us to stop charging for the review of our local government financial audits completed by private firms and submitting them to our office for review.

We've implemented a cost proposal process for our local government clients in January 2024 that gives greater transparency to our clients on upfront audit costs. It has been very well received by both our clients and staff.

Beyond the day-to-day work in our office, our staff enjoy supporting the communities we live in. Our Bismarck staff have organized an annual food drive competition across state agencies, with a traveling plaque, that collected over 18,000 items.

[slide 7] **Biennium Challenges**

In past biennia, petition audits create a lot of unknowns. We are grateful for the changes last session to our section of code changing “shall” to “may” which gives the Auditor’s Office greater discretion over conducting these audits to ensure that when the Auditor’s Office steps in that it is beneficial to the entity and the citizens. We’re working through two petition audits in 2025.

We invest a lot in training and developing our staff, with our own professional development requirements as government auditors and because of the specific nuances that come with our profession, we believe it takes 3 years to completely train a new person. Retaining these employees with some experience continues to prove difficult as they are the most sought-after candidates by other agencies and the private sector.

Training and education to these local governments continues to be a challenge. We have hired our training and education coordinator, thanks to the legislature last session for providing us that position. She has spent her first 9 months training on the reporting that these local government needs to complete. She has begun working on developing communication out to these local government, newsletter distribution lists, writing for CityScan and Assoc. of Counties, reaching out to these associations and offering training services, she has providing live training and education at seven different conferences and events, is recording video series around different government accounting topics with her first series covering all the different types of revenues these local government can have, her next series is on expenses. She is also working on creating downloadable resources for these small governments with her first one being about internal control environments in small governments. We’ve just scratched the surface with this position and we’re grateful for the resources from the legislature.

[slide 8] **Next Biennium Goals**

Our goal is to continue expanding and developing education for local governments across the state. We see a gap in professional and technical resources for these small governments and the Office of the Good Government is capable of fulfilling that need with appropriate investments.

Retaining our staff with competitive pay while understanding the future needs of our office. We are a young office that will need to actively develop our staff into leading roles very soon, as we have retirements quickly approaching.

Training opportunities for our staff to stay current on the government auditing and government accounting standards changes.

Automation and providing more transparency on local government finances. Currently, you can find cash and investments in our Power BI database on our website, our upcoming goals are to add long term debt, total expenses and total revenues.

[slide 9] **25-27 Requests Compared to Current Biennium**

- Improve transparency
- Reduce financial burden to local governments
- Enhance access to financial data of local governments

[slide 10] **Convert 3 special funded positions to general funded positions.**

Our special funded team consists of two audit teams and one review team. The review team conducts basic or extended reviews of annual financial reports for local governments that have less than \$2,000,000 in annual receipts. We have an opportunity to reinvent state government by keeping down cost for those smaller local governments, while continuing to help them with their financial transparency.

We've found internal efficiencies within our office that have allowed us to convert a special funded employee to a general funded position. The person in that position reviews local government audits from private firms. By converting this position, we are eliminating the extra expense to local governments who are already paying for high dollar audits. We feel like more can be done to save local governments money in this area. If we were allowed to convert two positions to general fund dollars, it would eliminate the billing process for the review of these annual financial reports.

By doing this, our team could focus on helping the most critical local governments to become current in their financial transparency efforts, without the local government worrying about how they will pay our office. Some of these local governments are behind on their submissions by 10+ years. A review fee of \$300 for each year could cost some small local governments their entire annual operating budget. This would be a total cost of \$380,344 for the two positions that are currently serving this function. Additionally, if these positions are converted it would allow our staff more time to answer questions that local governments have regarding the review, which helps in the education process.

U.S. Government Accountability Office government auditing standards, also known as the YellowBook, has released a new update for 2024. The previous version was released in 2018. As you can expect, there are significant changes. Due to the changes, we want to convert one additional position to general funded. The 2024 YellowBook has put an emphasis on quality management which has increased workload needs for the Quality Assurance team. This position would specialize in Single Audits and provide support to both our agency and local government divisions by focusing on compliance with standards, supporting our audit teams, and conducting internal training to staff. The surge in federal spending has increased the number of Single Audits needed for local governments and the Statewide Single Audit.

Federal funding has risen by 56% in North Dakota thanks to ARPA, SLFRF, and CARES funding. Our team is currently finishing up one of the largest Single Audit's our office has ever completed.

- Pre-Covid, the 2019-20 Single Audit had \$4,418,666,234 in federal expenditures.
- The 2021-22 Single Audit had \$6,683,485,219 in federal expenditures...a 51% increase.
- The 2023-24 Single Audit has \$6,871,854,565 in federal expenditures...a 56% increase.

Back in 2019-2020, our local government audit team completed Single Audits for five of our local government clients. In 2022-2023, that number increased by 300% to 16. Each of these Single Audits take a minimum of 40 additional hours and costs the clients around \$5,000.

This position would ensure consistency across our agency and would create efficiencies in our audit, while maintaining the audit capacity of single audit requirements and the increased number of new federal programs. This position would also ensure North Dakota is complying with the ever-changing federal audit requirements for federal programs.

[slide 11] **Cost to Continue Services**

This is based on former Governor Burgum's budget request.

The State Auditor's Office budget is 90% salaries and benefits of total appropriations. 7% of the total appropriations is for telecommunications, data processing, and rent expenses. The remaining 3% of total appropriations covers all other operating costs of the agency. This leaves very little flexibility when we need to find 3% savings. We're asking for these additional funds to continue operating considering the required 26% increase of fees established by NDIT as well as the increase in capitol rent. This also includes an increase in professional development and travel costs to keep pace with inflation, as well as state fleet increased costs to our agency for a total of \$135,775.

The next item again relates to the requirements of YellowBook. YellowBook requires the NDSAO to have a peer review done once every three years. A peer review is like a performance audit, where top-tier state auditor staff from across the country come to Bismarck and conduct a deep dive into our office processes and procedures to give assurance that the NDSAO is following proper government auditing standards. Our next peer review is scheduled for June 2026. Our most recent peer review was June 2023 and cost approximately \$20,000. The cost was covered in operating, but it can no longer be covered with the general fund cuts. We do not pay these individuals a salary to be here, however we do pay their travel expenses and these auditors travel here from various locations across the country.

The final cost we're requesting is related to our auditing software known as TeamMate. We're migrating to TeamMate+, as TeamMate AM is being discontinued. We began migrating to TM+ in September 2024. We have found some cost savings internally, such as reducing the number of employees who need TeamMate licenses and cleaning up data to save on storage costs. However, we will need to keep the current Teammate AM on the ITD servers through the summer of 2026 in order to migrate all data over that will need to be kept for records retention purposes. NDIT increased rates for servers from \$125 a month to \$2,000 a month, so the cost cannot be covered by previous appropriations. TeamMate AM will need to stay live and accessible to us until the transition from the old server to the new server can be finalized.

[slide 12] **Cost to Continue Salaries**

The State Auditor's Office is grateful for the increase in salary dollars we were given last session that allowed us to retain our top talent. The equity increases and legislative increases were one aspect of the total rewards program that played a vital role in keeping our turnover rate to a minimum. We're asking for the legislative increase provided on July 1, 2024, of 4% to continue paying our staff at their current salaries so we can retain top talent.

[slide 13] **Security Assessment**

Every biennium the NDSAO contracts out a security assessment of the state of North Dakota, including Higher Education. This is a critical resource for the state because it checks if security protocols are effective against today's cybersecurity threats. Our office has been allocated \$150,000 in general funds and \$300,000 in special funds in past biennia to procure this assessment. Because of our limited flexibility in operating funds, this was removed from our budget to meet budget guidelines. We're asking that this critical assessment be added back to our budget, but the funding mechanism be \$585,000 in general funds. As inflation has increased, the scope of the security assessment has decreased over the past few years. This is why the request is at the \$585,000. The reason why we're asking for it all in general funds is again due to the scope. It gives the contractor greater flexibility in identifying high risk areas and designing the audit procedures.

[slide 14] **Temporary Salary Line**

We spoke about converting the two positions that support small governments earlier. Our robust internship program has relied on the small government review process to train, evaluate, and provide an entry into the auditing process. If we stop charging these local governments, it cuts off the funding of our internship program.

In an employee's market, our team has created a low-risk, high reward internship program that serves as a talent pipeline for government auditors. This is critical for several reasons, considering accounting graduation rates are dropping dramatically, and private firms are offering six figure salaries. Since 2021, we've had 31 interns that resulted in 12 full-time employees. We have fully expended our \$100,000 in general fund temporary dollars with nearly 10 months left of the biennium. We're requesting an additional \$100,000, totaling \$200,000, in general fund temporary salaries to continue with this successful program.

[slide 15] **One federal funded FTE**

The Mineral Royalty division of our office is fully funded by the federal government and is a function of the Office of Natural Resources Revenue (ONRR) within the Department of the Interior. They use compliance reviews to verify that the State of North Dakota and the federal government receive the correct lease royalty money from energy companies that extract minerals on federal land within our state. This team of five people conducts over 22% of ONRR's yearly goal of compliance reviews alongside 13 other states and tribes. We're requesting appropriation authority for an additional person to expand the natural gas compliance review function of this office. These salary funds would come from the federal government, we're looking for appropriation authority for those salary and operating funds tied to one full-time person.

We have requested this position to be approved for the second half of the biennium as federal approval will be in FFY 26.

[slide 16] New Positions Approved

Last legislative session, four additional FTE were approved for our office.

1 position from the general fund, a Training and Education Coordinator, to help local governments. The appropriated dollars for this position were \$218,672. The amount requested from the New and Vacant FTE Pool was \$159,412 as hiring occurred on 11/1/23.

3 auditor positions were added in the special fund. These positions remain unfilled. Appropriation Authority was reduced by \$739,760 for these three positions into the New and Vacant FTE Pool.

[slide 17] Vacant Positions

At the beginning of the biennium, we had three general fund positions open and the newly created position, totaling four. The three carryover positions had signed offer letters tied to them from interns. Once they graduated with their degree, the staff started full-time. The Training and Education Coordinator was then filled November 1st, 2023.

Our voluntary turnover rate for the biennium is 12%. That equates to 8 people.

As of December 1st, 2024, as seen on the Vacant FTE report requested, we have 13 open positions. Of those 13, only one is general funded and we have plans to fill it this spring. We have a couple interns on staff that would be considered for the position.

The remaining open positions are special funded positions. The dollars tied to these positions are solely appropriation authority, as again, they are self-funded. Having these positions unfilled, doesn't incur any costs to the state but allows us to be reactive to the market. If one of these audit firms makes changes, they could potentially drop 60 clients into the market.

New and Vacant FTE Pool:

Below is breakdown of appropriations removed from SB 2004 last session by category.

	General Fund	Other Funds	Total
New FTE positions	(\$218,672)	(\$739,760)	(\$958,432)
Vacant FTE positions	<u>(375,577)</u>	<u>(276,409)</u>	<u>(651,986)</u>
Total	(\$594,249)	(\$1,016,169)	(\$1,610,418)

As stated previously, we did request \$159,412 (\$196,805 available, which is 90% of the deducted amount) from the general fund New FTE allocation.

We have made no other requests from the New and Vacant FTE Pool.

According to our last vacancy savings report submitted to OMB (through October 2024) we have used \$107,759, broken down as such:

Use of vacant position savings:		
Accrued Leave Payouts		35,635
Extra Salary Increases		33,271
Bonuses		24,027
Incentive/location Pay		-
Reclassifications		-
Extra Temporary salary Funding		-
Extra Overtime Funding		14,825
Other (identify)		-

\$60,338 is general funded.

[slide 18] **Funding for Each Program/Line Item**

Class	General Fund	Special Fund	Federal Fund	Total	% of Funding
	Agency Audits and	Local Government	Mineral Royalties		
	Operations	Audits and Reviews			
11710 - Salaries	9,258,856	4,155,436	1,373,022	14,787,314	87%
11730 - Operating	1,092,408	552,805	142,558	1,787,771	10%
11750 - Capital Assets	70,550	-	-	70,550	0%
11770 - IT Systems Security Review	150,000	300,000	-	450,000	3%
	<u>10,571,814</u>	<u>5,008,241</u>	<u>1,515,580</u>	<u>17,095,635</u>	
FTE	39	21	5	65	

Significant Operating Expenditures	Percentage of Operating
NDIT Costs	38%
Rent	27%
Travel and Professional Development	18%
	<u>83%</u>

[slide 19] **Current Biennium One-Time Finding**

23-25 One-time funding: \$138,550 Total

- \$9,000 appropriated in general funds for special fund FTE office equipment– have not spent this money. Positions have not been filled.
- Travel and professional development inflationary costs - \$59,000:
- \$22,000 general funds – on track to spend this money before end of the biennium.
- \$37,000 other funds – will not spend this money as vacant positions have not been filled and federal budget is being tightened up from federal agencies. Federal employees are not traveling for audits or training.

- Audit software migration capital asset appropriations - \$45,550 general funds.
- Have expended \$24,000 and expect to expend the rest before end of biennium.
- Equipment replacement capital asset appropriations - \$25,000 general funds.
- Have expended \$15,668 by replacing two copiers. No additional equipment is planned to be replaced.

<u>Description</u>	<u>Expenditure Type</u>	23-25 One-Time Funding			<u>Total</u>	<u>Expected Expenditures</u>	<u>Estimated Turnback</u>
		<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>			
1. New FTE Office Equipment	Operating	9,000	-	-	9,000	-	9,000
2. Travel and Professional	Operating	22,000	37,000	-	59,000	22,000	37,000
Development Inflationary Increase							
3. Audit Software Migration	Capital Asset	45,550	-	-	45,550	45,550	-
4. Office Equipment Replacement	Capital Asset	25,000	-	-	25,000	15,668	9,332
Total		<u>101,550</u>	<u>37,000</u>	<u>-</u>	<u>138,550</u>	<u>83,218</u>	<u>55,332</u>

[slide 20] One-time funding being requested

25-27 One-time funding:

- \$3,000 – Federal fund office equipment purchase
- \$25,000 – peer review – happens once every three years. General Fund
- \$25,200 – teammate server transition – general fund portion
- \$10,800 – teammate server transition – special fund portion

Total - \$64,000

- GF = \$50,200
- SF = \$10,800
- FF = \$3,000

25-27 Requested One-Time Funding

<u>Description</u>	<u>Expenditure Type</u>	<u>General Fund</u>	<u>Special Fund</u>	<u>Federal Fund</u>	<u>Total</u>
1. Federal Fund FTE Office Equipment	Operating	-	-	3,000	3,000
2. Peer Review	Operating	25,000	-	-	25,000
3. TeamMate Server Migration	Operating	25,200	10,800	-	36,000
Total		<u>50,200</u>	<u>10,800</u>	<u>3,000</u>	<u>64,000</u>

[slide 21] Deposits into General Fund

CHAPTER 54-10 STATE AUDITOR

54-10-01. Powers and duties of state auditor - Report. (Retroactive application - [See note](#))

1. The state auditor shall:
 - a. Be vested with the duties, powers, and responsibilities involved in performing the postaudit of all financial transactions of state government, detecting and reporting any defaults, and determining that expenditures have been made in accordance with law and appropriation acts.
 - b. Perform or provide for the audit of the general purpose financial statements and a review of the material included in the comprehensive annual financial report of the state in accordance with government auditing standards.
 - c. Except for the audit of the department of financial institutions as outlined in section 54-10-31, perform or provide for audits of state agencies in accordance with government auditing standards and legislative audit and fiscal review committee guidelines developed under section 54-35-02.10. Except for the annual audit of the North Dakota lottery required by section 53-12.1-03, the state auditor shall audit each state agency once every two to four years. Audits may be conducted at more frequent intervals if requested by the governor or the legislative audit and fiscal review committee. The state auditor shall charge an amount equal to the cost of the audit and other services rendered by the state auditor to all agencies that receive and expend moneys from other than the general fund. This charge may be reduced for an agency that receives and expends both general fund and nongeneral fund moneys. The charge for an audit

- General Fund revenue through 12/31/2024: \$304,062
- Projected fiscal impact of agency audits for 25-27 biennium: \$343,353.
- General Fund revenue w/o SA for 21-23 biennium: \$747,726

[slide 22] Deposits into Special Fund

- Local government division is a self-funded special fund
- 21 FTE
- The group bills local governments “an amount equal to the fair value of an audit” and the money is deposited into their operating account.
- Small government reviews, the authority is in section 54-10-14 and rates are set in code.

SF revenue through 12/31/24:

- Audits - \$2,020,729
- Reviews – \$492,784

[slide 23] Executive Budget

I did include a snapshot of Former Governor Burgum’s recommendation compared to our request. We understand that Governor Armstrong will release his recommendation tomorrow, but we wanted to address the previous recommendation during this initial hearing.

[slide 24] **Questions**

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