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Workforce Committee

Mr. Chairman and members of the interim Workforce Committee, for the record my name is Bob Peterson and I am the State Auditor. I appear before you today at the request of the chairman who requested that I provide information relating to performance audits conducted by my office. The handout contains the following information:

1. The section of Century Code which authorizes my office to conduct performance audits;
2. Some of the relevant generally accepted auditing standards that we are required to follow including a definition of performance audits as well as discussion about the various audit objectives which may be included in a performance audit. In addition we've included some information on the auditor's use of professional judgment during a performance audit;
3. A general description of how performance audits are selected;
4. A general description of the phases of a typical performance audit;
5. Qualifications of auditors and training requirements;
6. A description of the external Quality Control Review my office undergoes once every 3 years; and
7. Some overall observations regarding performance audits.

With me today is Gordy Smith who is the Performance Audit Manager and I will defer to him any technical questions the committee may have.

1. North Dakota Century Code (NDCC) Pertaining Performance Audits

North Dakota Century Code Section 54-10-01, Subsection 4

"Perform or provide for performance audits of state agencies as determined necessary by the state auditor or the legislative audit and fiscal review committee. A performance audit must be done in accordance with generally accepted auditing standards applicable to performance audits. The state auditor may not hire a consultant to assist with conducting a performance audit of a state agency without the prior approval of the legislative audit and fiscal review committee. The state auditor shall notify an agency of the need for a consultant before requesting approval by the legislative audit and fiscal review committee. The agency that is audited shall pay for the cost of any consultant approved."

2. Generally Accepted Auditing Standards Pertaining to Performance Audits

- a) Generally accepted auditing standards pertaining to governmental performance auditing are included in the document "Governmental Auditing Standards" issued by the Comptroller General of the United States. This document is commonly referred to as the "Yellow Book".
- b) Performance Auditing
Definition: "Performance audits are defined as engagements that provide assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability." (*Government Auditing Standards*, 2007 Revision)
- c) "Performance audit objectives may vary widely and include assessments of program effectiveness, economy, and efficiency, internal control, compliance and prospective analyses. These overall objectives are not mutually exclusive. Thus a performance audit may have more than one overall objective. For example, a performance audit with an initial objective of program effectiveness may also involve an underlying objective of evaluating internal controls to determine the reasons for a program's lack of effectiveness or how effectiveness can be improved." (*Government Auditing Standards*, 2007 Revision)
- d) The Yellow Book (*Government Auditing Standards*, 2007 Revision) provides examples of audit objectives in the categories of program effectiveness and results or economy and efficiency. These include:
 - "assessing the extent to which legislative, regulatory, or organizational goals and objectives are being met
 - "determining the current status or condition of program objectives or progress in implementing legislative requirements;
 - "assessing the reliability, validity, or relevance of performance measures concerning program effectiveness and results, or economy and efficiency"
 - "assessing the reliability, validity, or relevance of financial information related to the performance of a program;
 - "evaluating whether the audited entity is following sound procurement practices".
- e) The Yellow Book goes on to state "Examples of audit objectives related to internal control include an assessment of the extent to which internal control provides reasonable assurance about whether:
 - organizational missions, goals, and objectives are achieved effectively and efficiently;
 - management information, such as performance measures, and public reports are complete, accurate and consistent to support performance and decision making;
 - the integrity of information from computerized systems is achieved".

- f) The Yellow Book describes how auditors must use professional judgment in performing audits. This would include exercising reasonable care and professional skepticism. Professional judgment represents the application of the collective knowledge, skills, and experiences of the personnel assigned to the audit. The standards go on to state that the use of professional judgment does not imply unlimited responsibility nor does it imply infallibility on the part of the auditor or the audit organization. Absolute assurance is not attainable because of the nature of evidence and the characteristics of fraud.

3. How Performance Audits Are Selected

- a) Legislative Audit and Fiscal Review Committee (LAFRC). The LAFRC may request that a performance audit of aspects of a particular state entity, function or activity. Examples of such performance audits conducted by the State Auditor's Office over the past several years include: a performance audit of aspects of the UND School of Medicine and Health Services; a performance audit of aspects of the Department of Transportation; and a performance audit of aspects of the Department of Corrections and Rehabilitation.
- b) Legislature. The entire legislature may pass legislation requiring the State Auditor's Office to conduct a performance audit of aspects of a particular state entity, function or activity. Examples of such performance audits conducted by the State Auditor's Office over the past several years include: Department of Agriculture Wildlife Services Program; the Disaster Emergency Management agency and 911 services; North Dakota Veteran's Affairs and North Dakota Veteran's Home state agencies.
- c) State Auditor. The State Auditor can select a performance audit of aspects of a state entity, function or activity. Typically the performance audit team examines information (such as performance audits completed in other states, a review of recent trends in government, discussions with financial auditors, discussions with other states' auditors and/or information presented to our office requesting that a performance audit be conducted) prior to making a recommendation to the State Auditor. Examples of such performance audits conducted by the State Auditor's Office over the past several years include: University System Capital Projects, the Department of Commerce and Workforce Safety and Insurance.

4. Phases of a performance audit conducted by the Office of the State Auditor

- a) Preliminary Survey Phase is to gain a general understanding of the department/ organization, programs and/or functions and to focus the scope of the audit. The performance audit team reviews state and federal laws, policies and procedures, studies and reports, etc. Typically, surveys are sent to related parties (employees, legislators, etc.) and the client reviews a draft of the surveys prior to them being sent out. In addition, SAO conducts interviews or survey management of the client. The process also assists in obtaining information needed in developing the objectives of the audit (scope of the audit) as well as the audit programs.
- b) Field Work Phase is based on objectives developed at the end of the Preliminary Survey. The final decision on the objectives of the audit rests with the Office of the State Auditor. A copy of the objectives is provided to the client as well as to the LAFRC. Testing necessary to accomplish the objectives of the audit is conducted during this phase.

During the fieldwork phase the audit clients are given the option of receiving periodic updates on the progress of the performance audit. The client can select either to have the progress report come in the form of a phone conversation or an email update at whatever time intervals they desire.

- c) Report Phase a draft copy of the report is distributed to the client and this draft copy is a confidential document. The client has a minimum of two weeks to respond to all the recommendations included in the report (additional time will be provided if no deadlines or meeting dates are to be met). Responses are included in the report immediately after the recommendation. All recommendations have been discussed with the client prior to the draft report being provided to them. All performance audit reports are presented to the Legislative Audit and Fiscal Review Committee.

5. Qualifications of Auditors

Our auditors must possess a bachelor's degree in accounting and possess good communication skills. In addition to general training provided to the staff annually we also try to find specific performance audit training for the audit team. This specialized training is generally provided out of state and our budget limits the amount of this type of training we can provide. However all of our professional staff receives a minimum of 80 hours of continuing professional education every two years as is required by the Yellow Book.

6. Quality Control Review

Every 3 years, a team of auditors from other states reviews the system of quality control of the Office of the State Auditor. This quality control review (also referred to as a "peer review") is required by the Yellow Book (Government Auditing Standards). This review is done in accordance with policies and procedures for external peer reviews established by the National State Auditors Association. The purpose of the quality control review is provide an opinion on whether the Office of the State Auditor has a system of quality control to provide reasonable assurance of conforming with government auditing standards. The peer review team and its members are required to be independent of the organization it is reviewing

In the last 3 peer reviews conducted (covering 9 years of our performance audits) there has not been a single finding related to the performance audits conducted by the Office of the State Auditor.

7. Performance Audits-General Comments

- a) The vast majority of state governments have a performance audit function (estimated 80-90% of states);
- b) The North Dakota State Auditor's Office has conducted more government performance audits than all of the CPA firms in the state combined;
- c) North Dakota statute previously required Job Service North Dakota to have a performance audit conducted by CPA's on aspects of its operations. The proposals submitted by the two CPA firms bidding on the 2004 project averaged \$156 per hour for the project. That was more than 6 years ago and it's safe to say the hourly rates have increased since that time. It's also important to note that the bid price did not include determining the scope of the project as that was done by the State Auditor's Office when it prepared the request for proposal.
- d) The performance audit team also conducts audit follow-ups during the year. Generally 18-24 months after a performance audit is presented to the Legislative Audit and Fiscal Review Committee the audit team returns to the client to conduct limited testing to gain assurance as to whether the recommendations have been implemented. The audited entity is provided the opportunity to provide their perspective on whether each recommendation has been fully implemented, partially implemented or not implemented.