



TESTIMONY TO SENATE APPROPRIATIONS

HB 1004 – STATE AUDITOR’S OFFICE APPROPRIATIONS

3/19/2021

Good morning, Chairman Holmberg, members of the committee, my name is Joshua Gallion, and I serve as North Dakota’s State Auditor. Our job is to lead the way in providing truthful, objective, and independent information to you and the citizens of North Dakota. Our mission is to produce informative audits that improve government, and our team is committed to generating greater value for taxpayers.

I’m here today to share about the substantial shortage of government auditors in our state, and how it is impacting every single North Dakotan. When I started in this role back in January of 2017, our local government team was working with 53 clients, or 10% of the total local governments requiring an audit.

Since that time, we have discovered several areas that were in need of improvement. As you are aware, state law requires either an audit or the review of annual reports submitted from a local government. The list of the entities that fall under the title “local government” is incredibly extensive and includes over 24 different areas ranging from airports and cities, to educational districts, and water districts. For the full list, please see Appendix A.

One of the first things I asked from that team was to understand their universe of audit clients. Who were they? And were we receiving regular audit reports or annual reports? Come to find out, there are just under 2,000 local governments who should be getting an audit or submitting an annual report.

Because of the research done by the team and the contact resource management tracking software we have put into practice, we’ve determined 264 local governments are a combined 470 years behind in their audits. And every year that number continues to grow because we are understaffed to make any headway on this number.

Fast forward to 2020, our local government team of 10, is stretched to their absolute maximum capacity. In addition to the 53 audit clients we serve each year, our office is experiencing a surge in workload. This stems from petition audits, citizen-raised concerns that lead to additional audits, governor requested audits, as well as a tremendous lack of private firms willing to perform these essential services.

To the best of my knowledge, our office had never received a petition audit until 2019. Once news spread, we saw a sharp increase in the number of citizen concerns shared with our office, which has resulted in us taking over some audits because of validated concerns. Our team has received twice as many citizen-raised concerns in the first two months of 2021, then in all of 2020. As the awareness of our office continues to grow, I cannot imagine what the next three months will hold for this team that is already stretched to their breaking point. We have had to implement a waiting list because of the amount of local governments who want to receive an audit from our team. We presently have 26 local governments who are on that list. Some of those have been on there for many, many years. See Appendix B for the full list.

Since the last session, we have discovered there are more clients who need our help. This is for several reasons including:

- Local governments cannot find any auditor who can conduct their audit.
- Local governments cannot find an affordable auditor.
- Local governments only need a one-year audit and they cannot afford a private firm.
- Past auditors that these local governments hired never issued any recommendations to improve their accounting practices.
- Their current auditor is providing poor service.
- Local governments have crossed the amount of money that mandates an audit for the first time and have never had an audit.
- Local governments are more than five years delinquent.
- Local governments have never submitted an audit (as required by law).

There are simply too many to audits and not enough private firms to handle the demands of local government audits. I'm here today to explain the lack of available resources in government auditing in North Dakota and how the Auditor's Office would like to help.

Before I continue, I would like to share how our local government division is funded. All operations from the local government division are special-funded, meaning no general funds are needed. Revenues generated from conducting audits are deposited into a special fund and all related expenses — including salaries — are paid from that special fund. Since we testified on this bill in January, we've been made aware of 67 clients who are potentially going to lose their auditor. Because of that, we are in need of 10 additional full-time employees for our local government division, in addition to the two FTE's the House authorized. With the two full-time employees we received last session, we were able to audit an additional 10 local governments last year.

It's not a matter of if we have enough workload, we have more than enough to keep 12 additional auditors busy, see Appendix C for additional details. These additional staff members will help us start chipping away at the 554 delinquent audit clients on top of the added workload these petition audits, citizen-concerns, and governor requested audits add to our already overwhelmed task list.

This also isn't about wanting to increase our FTE or grow government. I believe in limited government. However, I also believe in a responsive government and that is why I'm here today asking for additional staff. We need to meet the needs of every single one of our local governments. We have an obligation to provide a quality audit these local governments can learn from and one that citizens can have an assurance that their tax dollars were spent properly.

My biggest concern in government auditing is not within state agencies. It is in local governments where many times there are volunteers who have limited skills, knowledge, and expertise to properly maintain financial records. Many times, there is a lack of segregation of duties, if no one is looking, this fuels the opportunity for errors and fraud. Misuse of funds and fraud are happening regularly at the local level and this leads to increased costs for the taxpayers of North Dakota.

Our plan, if we were given these positions, would be hire them in a thoughtful, phased approach to give each auditor the training and time required to do perform their job at the highest standard.

We are asking for you to help us fill this void in North Dakota and make a dent on these delinquent audit clients. If we could double our team from 10 to 20, we could double our workload.

As Senator Dever said in last sessions conference committee, "Giving the State Auditor more local government auditors is a win for the state and a win for the local governments."

We could not agree more.

I would also like to discuss the two general funded positions that the House removed. When positions are eliminated, we are forced to limit the extent of the scope for each audit in order to accomplish audits. This leaves more high-risk areas unattended. It leaves a greater chance for things to go unnoticed when we do not have the resources to look.

Those vacancy dates attached to the position numbers were not truly accurate. To keep the process simple for administration purposes, when someone leaves a position, we wouldn't necessarily grab the oldest vacant position number. We were following a last one in, first one out system when putting new people into positions numbers. We have revised our hiring process so that will not be an issue next session. As for the position that was vacant for 18 months according to the Internet Budget Analysis and Reporting System (iBars) report, that position was filled since crossover and that person will join our team on Monday.

We have a critical need for four general-funded auditor positions to help alleviate the stress of the state's increased budget expenditures on our staff.

Our agency staff have put in nearly 600 hours of overtime in 2020 to complete the Comprehensive Annual Financial Reports and Single Audit on time. We have seen an increase in the number of state agencies that require audits such as the Department of Environmental Quality, the Forest Service, Ethics

Commission, and the Upper Great Plains Transportation Institute. These are all first time audits and these extra audits force us to shorten other audits.

If the Department of Health and Department of Human Services do combine (HB 1247), you will be combining two of our largest state agencies into one. It will take our staff additional planning time to understand all of the new combined processes and procedures because of the new risks that are created. As the risk goes up, the time needed to do an audit goes up. We already have increased risk from the last legislative session due to the restructuring of human service center zones, which are being implemented in the current biennium. Currently in a 12-month cycle, our team is at the Department of Human Services for approximately 9 months. With an entity as large as these two combined, we would need to have a dedicated team that would be at this agency year-round.

Reinstating those two general funded positions and allowing us two more will allow our staff the opportunity to provide the assurance to the legislative body and citizens that taxpayer funds are being used appropriately.

A few other items in our budget I wanted to touch on briefly:

We're asking for \$450,000 to continue with the Cybersecurity audit that is done every other year. This audit is done across State of North Dakota and the University System. The purpose of this audit is to identify our most significant security risks in state government and higher education so that we can make changes that will protect our state from those risks. This past audit found 128 areas of concern with 62 of them being labeled critical or high risk.

Our total budget is 91% salary and 75% of our operating budget went to information technology, rent, and professional development.

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

APPENDIX A – LOCAL GOVERNMENTS REQUIRED TO SUBMIT AUDIT OR ANNUAL REPORT

Each entity indicated below has an extensive list of sub-categories that our office is required to audit. For the full list, visit: nd.gov/auditor/local-government-audit-reports

- Airport Authorities
- Area Career and Technology Centers
- Cities
- Correction Centers
- Counties
- Firefighters Relief Associations
- Garrison Diversion Conservancy District
- Health Units
- Irrigation Districts
- Job Development Authorities
- Park Districts
- Public Libraries
- Recreation Service Districts
- Regional Planning Councils
- Rural Ambulance Service Districts
- Rural Fire Protection Districts
- School Districts
- Soil Conservation Districts
- Southwest Water Authority
- Special Education Districts
- State Boards
- Water Resource Districts
- Weed Boards
- Western Area Water Supply Authority

APPENDIX B– STATE AUDITOR’S OFFICE WAITING LIST

- City of Dickinson
- Mercer County
- New PSD
- City of Beulah
- City of Reiley Acres
- Williams County
- McKenzie County Ambulance Dist.
- Garrison-Max Ambulance Dist.
- Williams County Soil
- Oliver-Mercer Special Ed Unit
- Bowman Slope SCD
- City of Rolette
- Horace Rural Fire Protection District
- East Central Special Ed Unit
- City of Glenburn
- City of Beach
- Watford City
- Forest River Joint WRD
- Park River Joint WRD
- City of Wilton
- Grant County SCD
- Ward County
- Mandan Rural Fire District
- Hope/Page PSD
- ND state board of accountancy
- Minnewaukan PSD

List of local governments without an auditor:

- Kindred RFPD
- Halliday RFPD
- McKenzie Co. RFPD
- Grenora RFPD
- Williston RFPD
- Trenton VFD
- Arnegard RFPD
- Burlington RFD
- Wildrose FPD
- Mandan RFPD
- North Central SCD
- Burke Co. SCD
- McKenzie Co. SCD
- Stutsman Co. SCD
- Stanley Park District
- Crosby Park District
- Emerado PSD

APPENDIX C – WORKLOAD INCREASES

Currently, we are aware of 40 local governments who need an auditor immediately. In 2008, 128 audit firms were licensed to do government audits in North Dakota. Today, only 14 are conducting government audits. As of January 1st, those 14 firms have 371 outstanding county, city, and school district audit reports due to our office. That’s not counting the water, fire, park, and other reports also past due. Recent retirements have left 24 local governments without an auditor, and when remaining independent CPAs retire, 79 local governments may not have the ability to provide assurance to the public that their tax dollars are being used properly.

New audit clients require us to move our regular clients into the next fiscal year. These new clients include:

Foster County *The last audit of Foster County was in 2012. Their audits are*
1,210 hours required *seriously delinquent and so we are working to get them caught up.*
 For: 2013 through 2020 audits

Napoleon Public School District *Past audits were not following government mandated auditing*
350 hours required *standards. This led to IRS penalties and fines totaling \$183,514.*
 For: 2018 through 2019 audits *(According to the Napoleon Homestead Newspaper.)*

Parshall Public School District *Past audits were not following government mandated auditing*
350 hours required *standards. This led to a citizen-initiated petition audit.*
 For: 2018 through 2019 audits

New audits next biennium in addition to our current client workload include:

| | |
|---------------------------------|--|
| Mercer County | 450 hours |
| Lamoure County | 250 hours going to an annual audit |
| Napoleon Public School District | 325 hours |
| Parshall Public School District | 325 hours |
| Extended Reviews | 120 hours for an additional six reviews |

These hours alone (**3,440**) will require an additional **2.21** full time employees. That's not counting the:

- 26 local governments that want us to be their auditor.
This would require an additional **4.73** full time employees.
- 24 local governments that do not currently have an auditor.
This would require an additional **4.36** full time employees.
- 79 local governments that are in situations where their auditor may soon no longer do audits.
This would require an additional **14.36** full time employees.

As of today, 554 local governments presently need an audit or need to submit annual financial reports. This would require **12.64** full-time employees estimating 64 of the 554 will need to get an audit, while the other 490 would need to submit an annual financial report for review.

264 local governments in the state are currently a combined 470 years behind in their audits.

We are also aware of 16 mentions of required audits in Century Code, but it does not say specifically who should be conducting those audits and none of those audits are reviewed by our office to ensure the standards or laws were properly followed.

APPENDIX D – AGENCY OVERVIEW & ACCOMPLISHMENTS

The duties and responsibilities of the State Auditor are included in Article V, § 2 of the North Dakota Constitution and Chapter 54-10 of the North Dakota Century Code.

The activities of the Office of the State Auditor are carried out through 58 employees in four divisions: Administration, Division of State Audits, Division of Local Government Audits, and Division of Mineral Royalty Audits.

1. Administration Division

The Administration Division provides oversight and support for the other divisions of the Office of the State Auditor.

Accomplishments

- Awarded second place for Most Improved Publication from the National Association of Government Communicators.
- Awarded Top 10 Workplace for Young Professionals by the Bismarck-Mandan Young Professionals Network.
- Out of 1,400 nominations our office was awarded 50 Best Places to Work from Prairie Business Magazine.

2. Division of State Audits

The Division of State Audits conducts performance, operational, information technology, and financial statement audits of state agencies as authorized by:

- N.D.C.C. 54-10-01 (2) “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 and perform or provide for the audits and reviews of state agencies. Except for the annual audit of the North Dakota lottery required by section 53-12.1-03, the state auditor shall audit or review each state agency once every two years.”

- N.D.C.C. 54-10-01 (4) “Perform or provide for performance audits of state agencies, or the agencies' blended component units or discretely presented component units, as determined necessary by the state auditor or the legislative audit and fiscal review committee.”

Accomplishments

- 42 - Agency operational audits are conducted every biennium.
- 12 - Higher education operational audits are conducted every biennium.
- 22 - Agency financial audits are conducted every biennium.
- 1 - Agency performance audit was conducted this biennium.
- 1 - Federal single audit is conducted every biennium.
- 2 - Comprehensive Annual Financial Report is conducted every biennium.
- 5 - Fraud investigations were conducted this biennium.
- Received the highest possible rating from the National State Auditors Association in the peer-review process.

3. Division of Local Government Audits

The Division of Local Government Audits — which is entirely self-funded (no general funds are used) — conducts audits of political subdivisions, small government reviews, and reviews of audit reports as authorized by:

- N.D.C.C. 54-10-13 (1) “The state auditor shall perform audits of political subdivisions pursuant to section 54-10-14 unless otherwise requested by the governing board, ordered by the governor or the legislative Page No. 2 audit and fiscal review committee, or on petition pursuant to section 54-10-15, or at the discretion of the state auditor for alleged improprieties.”
- N.D.C.C. 54-10-14 (1) “The state auditor shall audit the following political subdivisions once every two years.”
- N.D.C.C. 54-10-14 (3) “In lieu of conducting an audit every two years, the state auditor may require annual reports from school districts with less than one hundred enrolled students; cities with less than five hundred population; and other political subdivisions subject to this section, or otherwise provided by law, with less than three hundred thousand dollars of annual receipts, excluding any federal funds

passed through the political subdivision to another entity.”

- N.D.C.C. 54-10-14 (4) “A political subdivision, at the option of its governing body, may be audited by a certified public accountant or licensed public accountant rather than by the state auditor.” “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 government auditing standards.”

Accomplishments

- 78 local government audits are conducted every biennium.
- First petition audit completed. This audit was the Belcourt Public Schools 2019. Our audit reported 15 findings, some of which could have been identified by a previous auditor. Second petition audit is underway.
- First Governor Requested Audit (that we are aware of) for the Oberon Public School District 2020-2019. Governor Burgum requested this audit because of financial discrepancies from the Oberon Public School District that were uncovered during an investigation by the Bureau of Criminal Investigation.
- The First Stewardship award was given to the City of Devils Lake 2020. This award celebrates excellence in auditing and is given to local governments the State Auditor’s Office has worked with conducting audits. The criteria for the award includes no significant deficiencies that are identified, no ethical or financial concerns, and a strong commitment to serving the taxpayers of North Dakota.

4. Division of Mineral Royalty Audits

The Mineral Royalty Division of the State Auditor’s Office conducts compliance reviews and audits of federal royalty payments and revenue from oil, gas, and coal leases across North Dakota. The Mineral Royalty Division of the State Auditor’s Office is fully funded by the federal government. There are currently 10 states and seven Native American tribes participating in this program with the Office of Natural Resources Revenue through the U.S. Department of the Interior.

Accomplishments

- 5 mineral royalty audits and 123 compliance reviews were conducted this biennium.
- Over \$230 Million in Federal Royalty Payments were verified by our office for State and Federal Funding during calendar years 2015 and 2016.

APPENDIX E – HISTORY OF THE STATE AUDITOR’S OFFICE

Brief Historical Perspective

1889 – North Dakota's first State Auditor took office. Much as county and city auditor’s function to this day, for the first 72 years of the state’s existence, the State Auditor functioned as a bookkeeper or accountant rather than a true “auditor.”

1961 – The State Auditor’s responsibilities were changed to performing the post audit of all financial transactions of state government. At the time this meant auditing 100 separate departments.

1969 – The State Auditor began performing audits of political subdivisions.

1971 – The Legislature gave counties the option to contract for their own audits and soon after that other political subdivisions were given the same power.

1973 – The State Auditor modernized operations by adopting generally accepted auditing standards.

1975 – The State Auditor started to conduct performance audits to help improve the effectiveness and efficiency of state government.

1982 – The State Auditor was given the responsibility for performing royalty audits to ensure royalties are properly paid on federal oil, gas and coal leases.

1984 – The Single Audit Act was passed. This act combined the responsibilities for auditing government financial statements with auditing compliance with requirements relating to federal financial assistance. The State Auditor was given this responsibility, significantly increasing the auditors’ workload.

1986 – Because of the demands of the Single Audit Act, performance audits were discontinued.

1991 – The Legislature funded positions for the State Auditor to establish a performance audit function.

1991 – The Legislature required the State Auditor to audit the state-wide financial statements also known as the comprehensive annual financial review. At this time, biennial agency audit reports went from including financial statements prepared in accordance with generally accepted accounting principles to only including reports on internal control and compliance with laws and regulations.

1991 – The State Auditor’s Division of Local Government Audits became self-sufficient by the establishment of an operating fund for its revenues and expenditures.

1997 – Biennial agency audits started to include a statement of revenues and expenditures and an appropriations statement.

2000 – Biennial agency audits switched to following the performance audit standards rather than the financial statement audit standards. This change was done in consultation with the Legislative Audit and Fiscal Review Committee.

2005 – The State Auditor received funding and authority to conduct the first information technology security audit of the state.

2013 – The first information technology security audit of the North Dakota University System was completed.

2015 – The Higher Education Audit Division established by N.D.C.C. section 54-10-30. Desktop support of computers was taken over by the Information Technology Department.