

September 2009

STUDY OF THE STRUCTURE AND REQUIREMENTS OF THE STATE AUDITOR'S OFFICE NECESSARY FOR AUDITING POLITICAL SUBDIVISIONS - BACKGROUND MEMORANDUM

Section 4 of 2009 House Bill No. 1129 (attached as [Appendix A](#)) provides for a study of the structure and requirements of the State Auditor's office necessary to carry out its auditing of political subdivisions, as required by law, including how such audits should be adequately self-funded. The Legislative Management has assigned this responsibility to the Legislative Audit and Fiscal Review Committee.

BACKGROUND INFORMATION

Statutory Requirements

North Dakota Century Code Sections 54-10-13 and 54-10-14 (attached as [Appendix B](#)) require the State Auditor to perform audits of political subdivisions. The State Auditor's office has identified the following 1,173 political subdivisions subject to audit:

- Counties (53).
- Cities (354).
- Park districts (186).
- School districts (193).
- Firefighters relief associations (4).
- Airport authorities (10).
- Public libraries (8).
- Water resource districts (20).
- Garrison Diversion Conservancy District (1).
- Rural fire protection districts (226).
- Special education districts (22).
- Area career and technology centers (5).
- Correction centers (4).
- Recreation service districts (1).
- Weed boards (2).
- Irrigation districts (6).
- Rural ambulance service districts (12).
- Southwest Water Authority (1).
- Regional planning councils (8).
- Soil conservation districts (57).

North Dakota Century Code Section 54-10-14 further provides that the State Auditor shall charge the political subdivision an amount equal to the fair value of the audit and any other services rendered. In lieu of audit reports every two years, this section allows the State Auditor to receive annual reports from school districts with less than 100 enrolled students; cities with a population of less than 500; park districts and soil conservation districts with less than \$200,000 of annual receipts; and other political subdivisions with less than \$100,000 of annual receipts, excluding any federal funds passed through the political subdivision to another entity. The State Auditor may charge up to \$80 an hour for the costs of reviewing the annual reports.

The section also allows political subdivisions to choose to be audited by a certified public accountant or licensed public accountant rather than by the State Auditor. The public accountant must comply with generally accepted government auditing standards and submit copies of the audit report to the State Auditor's office when the report is delivered to the political subdivision. The State Auditor must review the audit report and may review the public accountant's workpapers to determine if the report and workpapers meet generally accepted government auditing standards. The State Auditor may charge the political subdivision a fee of up to \$80 per hour, not to exceed \$500, for costs related to reviewing the audit report and workpapers.

State Auditor's Office

The State Auditor's office's Division of Local Government Audits is primarily responsible for auditing political subdivisions, reviewing audits submitted by public accounting firms, and reviewing annual reports submitted in lieu of audit reports. The State Auditor's office, in its 2009 budget request, removed three full-time equivalent positions due to the closing of the local government audit office in Bismarck. The Division of Local Government Audits is now located in the Fargo office and currently has six full-time equivalent auditor positions and two part-time temporary auditor positions. The 2009 Legislative Assembly provided approximately \$1.34 million of special funds for the division for the 2009-11 biennium.

During the 2007-09 biennium, the Division of Local Government Audits completed 111 audits of political subdivisions, reviewed approximately 440 reports prepared by certified public accountants or licensed public accountants, and reviewed approximately 1,000 annual reports submitted in lieu of audits.

Audit Standards

Political subdivision audits are conducted in accordance with generally accepted government auditing standards. Government auditing standards include general standards relating to independence, professional judgment, competence, quality control, and assurance. Audit standards are published in the United States Government Accountability Office's *Government Auditing Standards*, commonly referred to as the "Yellow Book."

2009 RELATED LEGISLATION

As previously stated, Section 4 of 2009 House Bill No. 1129 provides for a study of the structure and

requirements of the State Auditor's office necessary to carry out its auditing of political subdivisions, as required by law, including how such audits should be adequately self-funded. In addition, the bill provides for an increase in fees from \$50 to \$80 per hour for reviewing annual reports and audit reports submitted by public accounting firms. The bill also changes the population criteria from "less than three hundred" to "less than five hundred" for cities that may submit an annual report in lieu of an audit.

PROPOSED STUDY PLAN

The following is a proposed study plan for the committee's consideration in its study of the structure and requirements of the State Auditor's office necessary to carry out its auditing of political subdivisions:

1. Receive and review information regarding a history of the State Auditor's office's Division

of Local Government Audits, including funding and staffing levels.

2. Receive and review information regarding the State Auditor's office staffing needs, revenues, and costs relating to conducting political subdivision audits.
3. Receive testimony from other interested persons regarding the study of the structure and requirements of the State Auditor's office necessary to carry out its auditing of political subdivisions.
4. Develop recommendations and any bill drafts necessary to implement the recommendations.
5. Prepare a final report for submission to the Legislative Management.

ATTACH:2

SECTION 4. LEGISLATIVE COUNCIL STUDY - AUDITS OF POLITICAL SUBDIVISIONS.

During the 2009-10 interim, the legislative council shall study the structure and requirements of the state auditor's office necessary to carry out its auditing of political subdivisions, as required by law, including how such audits should be adequately self-funded. The legislative council shall report its findings and recommendations, together with any legislation necessary to implement the recommendations, to the sixty-second legislative assembly.

54-10-13. Political subdivisions - Audits - State auditor powers. 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 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.

54-10-14. Political subdivisions - Audits - Fees - Alternative audits and reports. The state auditor shall audit the following political subdivisions once every two years, except as provided in this section or otherwise by law:

1. Counties.
2. Cities.
3. Park districts.
4. School districts.
5. Firefighters relief associations.
6. Airport authorities.
7. Public libraries.
8. Water resource districts.
9. Garrison Diversion Conservancy District.
10. Rural fire protection districts.
11. Special education districts.
12. Area career and technology centers.
13. Correction centers.
14. Recreation service districts.
15. Weed boards.
16. Irrigation districts.
17. Rural ambulance service districts.
18. Southwest water authority.
19. Regional planning councils.
20. Soil conservation districts.

The state auditor shall charge the political subdivision an amount equal to the fair value of the audit and any other services rendered. The fees must be deposited in the state auditor operating account. The state treasurer shall credit the state auditor operating account with the amount of interest earnings attributable to the deposits in that account. Expenses relating to political subdivision audits must be paid from the state auditor operating account, within the limits of legislative appropriation.

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; park districts and soil conservation districts with less than two hundred thousand dollars of annual receipts; and other political subdivisions subject to this section, or otherwise provided by law, with less than one hundred thousand dollars of annual receipts, excluding any federal funds passed through the political subdivision to another entity. If any federal agency performs or requires an audit of a political subdivision that receives federal funds to pass through to another entity, the political subdivision shall provide a copy to the state auditor upon request by the state auditor. The reports must contain the financial information required by the state auditor. The state auditor also may make any additional examination or audit determined necessary in addition to the annual report. When a report is not filed, the state auditor may charge the political subdivision an amount equal to the fair value of the additional examination or audit and any other services rendered. The state auditor may charge a political

subdivision a fee not to exceed eighty dollars an hour for the costs of reviewing the annual report.

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 public accountant shall comply with generally accepted government auditing standards for audits of political subdivisions. The report must be in the form and content required by the state auditor. The number of copies of the audit report requested by the state auditor must be filed with the state auditor when the public accountant delivers the audit report to the political subdivision. 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. The state auditor also may periodically review the public accountant's workpapers to determine if the audit meets generally accepted government auditing standards. If the report is in the required form and has the required content, and the report and workpapers comply with generally accepted government auditing standards, the state auditor shall accept the audit report. The state auditor may charge the political subdivision a fee of up to eighty dollars an hour, but not to exceed five hundred dollars per review, for the related costs of reviewing the audit report and workpapers.

A political subdivision may not pay a public accountant for an audit until the state auditor has accepted the audit. However, a political subdivision may make progress payments to the public accountant. A political subdivision shall retain twenty percent of any progress payment until the audit report is accepted by the state auditor.

The state auditor may require the correction of any irregularities, objectionable accounting procedures, or illegal actions on the part of the governing board, officers, or employees of the political subdivision disclosed by the audit report or workpapers, and failure to make the corrections must result in audits being resumed by the state auditor until the irregularities, objectionable accounting procedures, or illegal actions are corrected.