GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2025 Biennium

Bill information:	
HB0262 - Revise local government financial reporting and audit requirements (Schillinger, Jerry)	
Status:	As Introduced

☒Significant Local Gov Impact ☒Needs to be included in HB 2 ☒Technical Concerns

☐Included in the Executive Budget ☒Significant Long-Term Impacts ☐Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2024 Difference	FY 2025 Difference	FY 2026 Difference	FY 2027 Difference
Expenditures:				
General Fund	$4,500,061	$4,803,152	$5,066,237	$5,274,732
Other - Proprietary	($955,301)	($907,864)	($921,482)	($935,305)
Revenue:				
General Fund	$3,000	$3,000	$3,000	$3,000
Other - Proprietary	($955,301)	($907,864)	($921,482)	($935,305)
Net Impact-General Fund Balance:	($4,497,061)	($4,800,152)	($5,063,237)	($5,271,732)

Description of fiscal impact: This bill requires all local governments to have an audit at least every five years and the Department of Administration (the department) to pay half of the audit costs. The department will also be required to fund, and implement, a mandatory reporting system that is compatible with the reporting capabilities of each local government entity required to submit a report.

This legislation requires a funding shift from the proprietary fund to the general fund due to the elimination of the requirement for local governments to pay a fee upon filing the annual financial report with the department. The department cannot determine the fiscal impact of the proposed mandatory reporting system or the fiscal impact to the local governments, which may be required to update or implement changes to existing systems or processes to accommodate the mandatory reporting system.

FISCAL ANALYSIS

Assumptions:

Department of Administration

1. The fiscal summary is based on the local government FY 2018 through FY 2022 audit patterns and audit costs incurred. For FY 2024, this amount is estimated at $3,894,760.

2. Entities that currently do not meet the requirements for an audit (about 900 entities based on audit pattern), will be required to have an audit at least every five years, with the first audit requirement being for FY 2027 (audit costs incurred in FY 2028). This assumes that none of the additional audits would be federal single audits, required when a local government expends $750,000 or more in federal funds.
3. The bill proposes a five-year audit cycle. Year five (FY 2027 audit with costs incurred in FY 2028) of the analysis is addressed in the long-term impact section.
4. An estimated inflation factor of 9% was used for fiscal years 2024 and 2025. An inflation factor of 6% was used for all future fiscal year audit cost estimates (FY 2026 – FY 2028). The actual costs of all audits combined have increased by an average of 9% per year between FY 2020 and FY 2022.
5. Due to the immateriality, this analysis does not factor in the effect of adverse opinions, or disclaimers of opinions, in determining the five-year gap between audits.
6. Since the state will not be required to pay for voluntary audits, the cost of these audits is not included in the fiscal summary.
7. This bill proposes eliminating the filing fees for annual financial reports paid by local governments. These fees (approximately $700,000 annually) are deposited into the department's Local Government Audit and Reporting Program's proprietary fund.
8. Other revenue in the proprietary fund relates to audit roster fees ($3,000) and penalties ($41,000). The fiscal analysis does not include the penalties revenue since there is no stated due date of the annual financial report in the bill (see technical concerns below). Currently, penalties are calculated based on 60 days past the due date of the report.
9. Revenues in the proprietary fund are used to administer all aspects of the department for the Montana Single Audit Act, as defined in Title 2 Chapter 7, MCA.
10. The budgeted expenses in the proprietary fund for FY 2024 and FY 2025 equal $955,301 and $907,864, respectively. This includes personal services for 6.00 FTE. Amounts are inflated by 1.5% for FY 2024 and FY 2025.
11. The current fund balance in the proprietary fund is estimated at $430,000. This balance will be depleted when the local government services compliance reporting system is replaced at the end of FY 2023 or early in FY 2024. This fund balance would have been to operate the program for the next two years without having to increase rates. For purposes of this fiscal note, lost revenue due to the bill is assumed to be equal to the expenditures of the bureau.
12. The expenses of the proprietary fund will need to shift to the general fund as there will be insufficient revenue to continue operations in the proprietary fund. The fiscal summary also shifts the revenue of $3,000 for audit roster fees collected from the proprietary fund to the general fund.

Office of Public Instruction

13. A school district is a local government entity but is described independently in existing statute and this bill when the requirements are different than general local government requirements.
14. In accordance with 2-7-503(1)(a), MCA, school districts and associated cooperatives will comply with 20-9-213, MCA, and report to the Office of Public Instruction (OPI).
15. The United States Department of Education prescribes the form and timing of audits of school districts and school cooperatives that exceed the threshold established by the director of the federal Office of Management and Budget pursuant to 31 U.S.C. 7502(a)(3), as well as the responsibility of state education agencies to review and approve actions to remediate audit findings.
16. In accordance with 2-7-503(2), MCA, the OPI will continue to use and maintain the OPI reporting system, MAEFAIRS, as the primary reporting tool for the school districts.
17. The OPI expects the number of school audits to increase in the near future due to the increased revenues of school districts from the ESSER funding.
18. The bill amends 2-7-503(3)(b), MCA, that a school receiving an adverse opinion or a disclaimer in the most recent audit or review would be required to have an audit, even if it does not meet the criteria for an audit.

19. The bill in 2-7-515(3), MCA, changes the criteria for withholding funding from local government entities. According to 20-9-344, MCA, however, only the Board of Public Education has the authority to withhold funding from school districts.
20. The bill in 2-7-506(3), MCA, requires the department to pay one half of the total audit costs which are currently paid entirely by school districts.
21. The bill in 2-7-514, MCA, strikes the payment of the filing fee by the OPI for school districts, reducing OPI expenditures by $350,000 each year. This amount has been inflated by 1.5% for FY 2024 and 2025.

FTE	0.00	0.00	0.00	0.00
Expenditures:				
Operating Expenses - OPI	($350,000)	($350,000)	($355,250)	($360,579)
Operating Exp. - Audit Costs	$3,894,760	$4,245,288	$4,500,005	$4,700,006
TOTAL Expenditures	$3,544,760	$3,895,288	$4,144,755	$4,339,427
Funding of Expenditures:				
General Fund (01)- Fund Switch	$955,301	$907,864	$921,482	$935,305
General Fund (01)- New Costs	$3,894,760	$4,245,288	$4,500,005	$4,700,006
General Fund (01) - OPI	($350,000)	($350,000)	($355,250)	($360,579)
Other - Proprietary	($955,301)	($907,864)	($921,482)	($935,305)
TOTAL Funding of Exp.	$3,544,760	$3,895,288	$4,144,755	$4,339,427
Revenues:				
General Fund (01)- Fund Switch	$3,000	$3,000	$3,000	$3,000
General Fund (01)- New Costs	$0	$0	$0	$0
General Fund (01) - OPI	$0	$0	$0	$0
Other - Proprietary	($955,301)	($907,864)	($921,482)	($935,305)
TOTAL Revenues	($952,301)	($904,864)	($918,482)	($932,305)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)- Fund Switch	($952,301)	($904,864)	($918,482)	($932,305)
General Fund (01)- New Costs	($3,894,760)	($4,245,288)	($4,500,005)	($4,700,006)
General Fund (01) - OPI	$350,000	$350,000	$355,250	$360,579
Other - Proprietary	$0	$0	$0	$0

Effect on County or Other Local Revenues or Expenditures:

Department of Administration

1. Every five years, there will be an audit cost to approximately 900 local government entities that currently never meet the requirements of an audit (at least $750,000 in revenue).
2. Assuming the department must pay for half of the audit costs, the local governments will see a cost savings of approximately $4.0 million annually (between FY 2024 and FY 2028) for typically scheduled audits.
3. The cost to the local governments required to have an audit for the first time in five years (Year 5 of the audit cycle – FY 2027) is estimated at $7.1 million (1/2 the total additional cost of $14.2 million) in FY 2028.
4. A net increase of audit costs across all local governments is calculated to be $3.1 million over the five-year audit cycle.

Long-Term Impacts:

Department of Administration

1. Under the assumptions noted above, FY 2027 is the required year for an audit of any local government not previously subject to an audit (audit costs will be incurred in FY 2028). Based on the past five fiscal years, approximately 900 local governments never meet the requirements for an audit (at least $750,000 in revenue). This analysis assumes an audit would impact those same 900 entities in FY 2028 for FY 2027 audits. The impact to the department for the **additional** audit costs in FY 2028 is $7.1 million (stated at 50% of the total cost). The total difference for FY 2028 is estimated to be $12.1 million (with growth).

Technical Notes:

Department of Administration

1. This legislation does not state a due date for the annual financial report (AFR). The current due date in statute is six months from the end of the fiscal year. The department will only be able to assess late fees if there is a stated due date for the AFR.
2. The format of the new annual financial report needs to be clarified. The bill indicates a cash basis profit and loss summary by fund. Governments do not report net income. This report format ignores other current assets, capital assets, payables, long-term debt, and interfund activities.
3. The format of the proposed AFR does not consider the different types of entities and all the different operations. This will reduce uniformity and consistency of data collection and transparency. This bill allows local governments to submit budgets in any form or format, which could lead to inconsistency in reporting and transparency.
4. Page 1, line 27: Clarification or a definition is needed for the term "external requirements".
5. The bill allows audits in lieu of an annual financial report due within one year. Audits in lieu are currently accepted as an alternate form of an AFR within the current due date of six months from the end of the fiscal year.
6. The term "capabilities" of each local government's reporting system is unclear and requires definition.
7. More information on the mandatory reporting system is needed to assess its feasibility. For example, the data to be captured in the system, the timing of implementation, and the responsibility of the local governments to provide data.
8. Page 2, line 25: The bill text indicates that audits must be conducted in accordance with generally accepted accounting procedures. The correct terminology is generally accepted accounting principles (or GAAP).
9. The bill contains an incorrect statement that audits must be conducted in accordance with GAAP. Audits are conducted in accordance with generally accepted auditing standards (GAAS). The entity presents its financial statements in accordance with GAAP.
10. It is unclear if this bill intends that all local governments would be subject to an audit every five years. The base year for determining when the five-year audits are required needs to be stated.
11. Page 3, lines 1 through 5 needs clarification. The language that an entity can elect a financial review instead of an audit every five years conflicts with page 2, lines 21 through 25 of the bill.
12. It is unclear if this bill intends that the only audits required are federal single audits as required by the Office of Management and Budget. The definition of a "required" audit is needed.
13. The bill provides that GAAP may inform, but does not control, financial review standards for local governments. Reviews are conducted in accordance with audit/attestation standards. Generally accepted accounting principles are a financial statement presentation framework for the entity.
14. Page 5, lines 12: This language reintroduces that the financial report must be submitted in a form required by the department (removed from 2-7-503 (1)(a), MCA). It is unclear if this refers to a format for physical upload only or the actual format of the report.
15. On page 5, line 14, the term "external requirements" needs a definition or additional clarity.

16. The bill requires the statements to be presented "by applicable fund." The definition of an applicable fund is unclear, and the text suggests reporting on all funds.
17. The bill removes significant findings from the audit and introduces the auditor's opinion as a factor in determining if an entity may be subject to state financial withholding. The state could withhold funding based on the auditor's opinion.
18. Removing the criteria that local governments must report "significant" findings in the newspaper suggests that all findings will be included. The current statute limits publication to 800 words.

Office of Public Instruction

19. Section 4(2)(a)(ii) limits the content of financial reports. Although Section 4(2)(b), line 19-20 states "The superintendent of public instruction shall prescribe the general methods and details of accounting for financial reports for schools", this exception clause does not make an exception for the content of financial reports submitted by school districts. Section 4(2)(a)(ii) is in conflict with 20-9-213(6), MCA, that sets the timing and content of school district and school cooperative financial reports and with Section 1(2) of this bill.

	1-30-23		1-27-23
Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*