

LEGISLATIVE AUDIT DIVISION

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MEMORANDUM

TO: State Agency Personnel
FROM: Legislative Audit Division
DATE: November 7, 2023
RE: Financial Audit Reform Overview

In 2022, the Legislative Audit Committee contracted with a consultant on modernizing the overall approach to auditing the state's accounting records. In response, Legislative Audit Division (LAD) personnel proposed a new risk-based audit model involving a different type of agency oversight. House Bill 132 became effective April 19, 2023. This allowed LAD to move forward with its new model. It will include a comprehensive analysis of state operations, new types of interaction with agency personnel, identification of agencies or programs to audit based on identified risk factors, and potentially new types of audit services. LAD's transition to the new model will be a multi-year project requiring involvement of many parties at both the state and national level.

1. What are the major changes resulting from House Bill 132?

House Bill 132 allows LAD to move to a risk-based audit model. With this new model, LAD will refocus its audit efforts on activity that exhibits higher risk. Due to the prevalence and risk associated with federal funding, the model will include annual, rather than biennial, audits of federal programs.

2. At a high level, what changes should I expect for my agency?

Agencies with unique statutory or regulatory audit requirements, such as Montana State Fund and Board of Housing, and agencies that are component units of the state, such as the retirement systems, will experience minimal change. Agencies administering larger federal programs will experience a more frequent and comprehensive audit presence. Smaller agencies may experience a less frequent presence, with future audit efforts focusing on specific programs or subject matter.

3. What changes are already in motion?

The first change was suspension of some smaller agency audits for the 2025 biennium to allow for reallocation of people resources to reform work. LAD is also changing how certain audit findings are reported. Federal findings may appear in the Single Audit report, rather than the agency's blue cover report. More significant financial findings may appear in the Statewide Audit report.

4. Will you be suspending additional audits in the future?

LAD will consider suspending additional audits for the 2027 biennium. LAD may also limit its work at certain agencies to what is needed to complete the Statewide and Single Audits.

5. Will we be notified if our agency audit is suspended?

Yes. Agencies whose audits were suspended for the 2025 biennium were notified via email.

6. Will we be notified if only support work will be completed at our agency?

Yes. In addition, LAD anticipates expanding its future Statewide and Single Audit entrance conferences to ensure all affected agencies are aware of the work being performed.

7. Will there be traditional financial audits of state agencies in the future? If so, how often can we expect to receive one?

Each agency can anticipate a traditional audit on a recurring cycle. LAD intends to consult with members of the legislature, state agencies, and peer states in determining an appropriate cycle.

8. Will financial schedules still be available for indirect cost proposals?

LAD anticipates financial schedules will continue to exist but intends to consult with legislators and selected agency personnel to determine if an alternative format will better meet existing information needs. LAD prefers to eventually discontinue compilation engagements, so plans to work with the Department of Administration to allow agencies to generate their own financial schedules in the future.

9. Who will decide on the alternative financial schedule format?

As outlined in §5-13-101, MCA, the legislature "...is held finally accountable for fiscal policy...", so is responsible for audits to be assured its directives are carried out. Audits are used to furnish the legislature with factual information vital to the discharge of its duties. As such, the Legislative Audit Committee will continue to make the final decision on financial schedule format. LAD anticipates providing several potential formats for the Legislative Audit Committee to consider.

10. Our agency relies on our biennial audit to ensure we are managing our responsibilities properly. How can we ensure our finances are properly managed without biennial audits?

An audit does not relieve agency management of their responsibility to establish and maintain effective internal control. Internal testing should be used to confirm the agency's activity is being properly managed. MOM 399 provides guidance on establishing and testing internal controls.

11. Our agency doesn't have an internal auditor. How can we be expected to perform internal testing?

The requirement to conduct reviews, tests, and analyses of internal controls is not new. Agencies can use existing personnel or coordinate with other agencies. The lack of internal audit functions at many state agencies, however, is a topic LAD plans to address as part of the reform efforts. Well-designed internal audit functions contribute to well managed agencies. You can anticipate a broader discussion on this need within Montana state government.

12. Can we expect reduced audit-related workload once annual Single Audits are in place?

No, the opposite will occur. The same amount of work currently performed for two-year audit periods will be performed for each annual audit period in the future. This is due to minimum testing requirements for each audit period.

13. Are there any ways to reduce my agency's Single Audit-related workload?

Yes, agencies can reduce this workload by implementing effective internal control and complying with applicable federal regulations. Once LAD transitions to annual Single Audits, low-risk high-dollar programs can be audited every three years. To be considered low-risk, certain federal criteria must be met. This includes no indications of significantly increased risk and no significant findings in the most recent audit. Programs designated by a federal agency as higher risk are precluded from being considered low-risk. Low-risk high-dollar programs are replaced with high-risk low-dollar programs on a 4 for 1 basis, reducing overall audit related workload for agencies.

14. With your reporting changes, will my agency need to attend several audit hearings?

Possibly. Depending on identified findings, agency management may be asked to participate in up to three hearings: Single Audit, Statewide Audit, and the agency's own audit report. After LAD fully transitions to a risk-based audit model, the volume of hearings may fluctuate based on the extent of risk-based work performed at your agency.

15. Will these changes impact the cost of my audit?

Possibly. Starting with the 2027 biennium, LAD anticipates Single Audit related charges to increase. LAD will be evaluating billing options to better allow agencies to charge audit costs to federal funds to the maximum extent allowable as required by §17-7-141, MCA. These increases may be offset by reduced work in other areas.

16. What kinds of risk-based audits will you perform?

LAD intends to consult with peer audit organizations to determine if audit and report products used in other states may better serve legislator and agency needs here. LAD also intends to identify risk factors and associated metrics to continually monitor for the purpose of identifying audit topics.

Factors may include new, complex, or unusual financial activity; fraud risk patterns; and non-financial patterns indicative of risk, such as statutory changes, turnover, significant legislative concern, and taxpayer impact.

17. Will my agency be billed for risk-based work?

Possibly. We intend to determine how other states approach billing for risk-based work and evaluate options for doing so here.

18. Will my agency have an opportunity to participate in the financial audit reform efforts?

Personnel from many agencies will be asked to contribute their thoughts and ideas for various topics associated with the reform efforts. Examples include audit appropriation and billing methodology, internal service fund and charges for services fund testing, financial schedules format, ACFR acceleration and associated support work, annual Single Audit transition, frequency of traditional audits, and alignment of certain statutory requirements with reform efforts.

19. How can I remain informed on the status of the reform work?

LAD anticipates status updates at each Legislative Audit Committee hearing. LAD also plans to update its webpage to make materials provided to the Legislative Audit Committee more accessible.

20. Is there anything else my agency can do to help support this transition?

Yes. Prompt, complete responses to requests for information during the audit process will help support timely audit completion. Maintaining sound internal control over financial activity and federal program compliance will also be helpful.

21. Who can I call with questions about the reform efforts?

You may reach out to Angus Maciver at angus.maciver@legmt.gov or Cindy Jorgenson at cindy.jorgenson@legmt.gov. You may also reach out to LAD personnel working on your agency audit with more general questions.