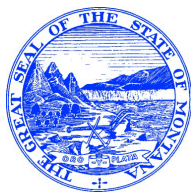


# LEGISLATIVE AUDIT DIVISION

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June 23, 2022

Members of the Legislative Audit Committee:

We have spent the past several months working with the Eide Bailly consulting team and our colleagues in the executive branch reviewing the financial audit model used by the Legislative Audit Division (LAD). This has been a constructive and valuable process and we are grateful to everyone involved for their time, effort and insights. The consulting report identifies important issues for both LAD and the State of Montana to consider. In some important respects, we have found ourselves in a situation where many of our practices do not conform to industry norms. While theoretical best practices should not dictate every aspect of our operations, Eide Bailly's work identifies significant questions relating to auditing standards, accounting and financial reporting, internal control, federal compliance, and risk management.

The consulting report contains twelve recommendations addressed either to LAD specifically, or to the legislature or state government more generally. Depending on the direction taken by the Legislative Audit Committee (LAC), change at this scale is likely to take a number of years and is also going to require close cooperation between different branches of government. Statutory revisions will need to be considered by the LAC to implement some of these findings. For these reasons, the following management response is in some cases conditional. Implementation of some of the recommendations will depend on the concurrence of the LAC and revisions to statutes.

## **Recommendation # 1**

Eide Bailly were initially retained as a result of the Audit Committee's strategic initiative addressing intergovernmental collaboration. We intend building on this work to engage closer with our colleagues in the other branches of government and to seek common ground. As part of a separate branch of government, LAD is structurally independent of our auditees in state agencies. Recognizing this reality should enable us to identify means of working together, without impairing independence. Many of the remaining recommendations in the report will, by nature, involve an ongoing commitment by both LAD and the other branches of government to identify meaningful changes that are mutually beneficial.

## **Recommendation # 2**

Professional certification has long been part of the ethos of the financial audit team. We will continue to prioritize supporting staff in their efforts to pursue certification. Identifying more resources in the form of time is a simple and cost-neutral solution we can implement. Other recommendations provide an opportunity for us to review resource allocation and think more about what we spend time doing. One benefit of a more efficient allocation of resources would be opportunities to invest more in staff training and professional development.

## **Recommendation # 3**

Cost competitiveness has always been our benchmark when considering outsourcing financial audit services. We are currently highly cost-competitive with private sector accounting firms and we believe that, in most cases, outsourcing financial statement audits for component units, fiduciary activities, and business type activities would result in additional costs. However, timeliness is a benchmark that we should be more conscious of. We need to commit to more timely delivery of our audit of the state's

Annual Comprehensive Financial Report (ACFR). Beginning next fiscal year, we will provide the Legislative Audit Committee with specific expectations for timeliness. Achieving these expectations will involve a degree of cooperation with the audited agencies, but it is incumbent on us to set the tone for this effort going forward.

**Recommendation # 4**

Our current approach to federal compliance testing does not result in timely reporting. With federal funds now comprising almost half of total state revenue, Montana needs to aspire to becoming a low-risk auditee, which means we need to expand federal testing coverage and integrate this work more seamlessly in the state's risk management approach for federal funds. The financial audit team is currently completing a review of the estimated additional costs associated with an annual Single Audit. However, this analysis will need to be considered together with other changes and these will depend on the direction ultimately chosen by the LAC and endorsed by the legislature through statutory changes.

**Recommendation # 5**

LAD has made significant investments in pay competitiveness over recent years. These efforts have been supported by the legislature through the appropriations process. However, we do recognize that although we have been able to remain competitive at entry levels, we still have ground to make-up at the manager level and above. The legislative branch has recently completed a market compensation survey and we are working with the branch HR manager to implement any needed changes in our pay plan. These efforts will focus more attention and resources on retention of more experienced staff than has previously been the case. Our budget request supporting these changes will be subject to review and approval by the LAC.

**Recommendation # 6**

LAD agrees in principle with the concept of developing a defined staff position focused on quality assurance and professional practice issues. In particular, a staff role that could work more closely with audited agencies on practice issues is a valuable concept. We have already developed a position description focused on advanced quantitative methodology and we are currently assessing how this role could also supplement existing quality assurance efforts within LAD. We will work with the LAC over the next few months to make decisions about reallocation of existing resources and/or appropriations requests in relation to this finding.

**Recommendation # 7**

Our training budget has seen moderate growth in recent years, but we are below the needed level of resources identified by Eide Bailly. As part of our budget request for the upcoming biennium, we will put forward a proposal to make permanent an additional \$20,000 in annual funding that is currently assigned as one-time-only resources for IT and technical training. Combined with some reallocation of existing operating authority, these modest additional investments will help us achieve the recommended level of funding for training and professional education. Our budget request supporting these changes will be subject to review and approval by the LAC.

**Recommendation # 8**

Although this recommendation is addressed more generally to state government, we agree in principle with the concept of codifying expectations for internal control systems and internal audit functions. A statutory basis for these activities is a common feature we see in other states, but that is currently lacking in Montana. Even where our state agencies do have well-developed internal controls and internal audit teams, these lack a statutory basis and guidance that would help our office integrate these assurances in our work. We believe many resources already exist in the other branches of government that could contribute to improving internal control systems and internal audit functions. What is needed is a broad-based commitment to standardization and institutionalization of these important management practices. Working with the LAC, we will provide whatever support is necessary to push this effort forward.

**Recommendation # 9**

As part of our current strategic planning cycle, LAD is developing a proposal to reinstate deputy-level leadership for the Information Systems audit team. We will also be proposing an appropriations decision package to provide for agency cost-sharing in an IS compliance audit cycle, including more time and effort focused on IT risk and cybersecurity. Our budget request supporting these changes will be subject to review and approval by the LAC.

**Recommendation # 10**

LAD is in the process of implementing a fully integrated audit management software platform. The new platform is being developed under contract with a third-party provider as a software-as-a-service product. The new platform is fully cloud-based and will integrate most, if not all, of our work papers management functionality (including aspects of agency communications). The new platform will be tested and implemented for all projects over the course of the next 18 months. This effort was fully funded by the legislature for the 2022-23 biennium.

**Recommendation # 11**

Expanding the scope and applicability of professional certifications is an achievable goal for us. We have recently begun funding renewal fees for staff with the CPA certification, and we also recently explicitly recognized the added market value for this certification as part of our market compensation survey. There are opportunities for us to incentivize staff to pursue other certifications (CFE, CGFM, CIA etc.) and for continued efforts to promote CISA and other IT industry certifications. As with recommendation # 2, staff time is the most important resource we have relative to professional development and we likely have sufficient existing budgetary authority to implement this recommendation.

**Recommendation # 12**

Implementing this recommendation will require the support of the LAC for revisions to statute that change the volume and/or frequency of our audit activity in agencies. These kinds of changes in the Legislative Audit Act will need to be contingent on necessary changes in risk management practices throughout state government. Reducing our agency accounting and state compliance coverage is only possible if the legislature has assurances regarding its constitutional responsibility to ensure strict accountability. Eide Bailly makes useful suggestions for achieving this, including documented agency internal control plans and management representations as part of the ACFR audit. Over the next few months, we will work closely with both the LAC and our colleagues in the other branches of government to identify broad outlines for the scale, scope and pace of these changes. By the October Audit Committee meeting, we will provide an assessment that identifies potential initial steps that can be considered to address this recommendation.

Again, we wish to express our gratitude to Eric Berman and his team from Eide Bailly. These recommendations provide a constructive path forward that will strengthen the legislature's accountability mission, while also improving the efficiency and effectiveness of our operations. We look forward to working with each member of the LAC to identify and implement meaningful changes in how we do business and how we can better serve the citizens of our state.

Sincerely,



Angus Maciver  
Legislative Auditor