

# LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
William Soller

## MEMORANDUM

**TO:** Members of the Legislative Audit Committee  
**FROM:** Jen Erdahl, CPA, Financial-Compliance Audit Manager. JLE  
**DATE:** December 2022  
**RE:** Financial-Compliance Next50 Risk-Based Model

At the October audit committee meeting, we presented a new audit model for financial compliance. That model included completing an annual audit of the Annual Comprehensive Financial Report (ACFR) and related component units, a biennial or annual Single Audit, and using remaining staff resources to perform risk-based work (the level of which would depend on staffing levels). After further discussion in our office, the Legislative Auditor and Deputy Legislative Auditor recommend transitioning to an annual Single Audit, given the nature of federal funding the state receives. A Single Audit, including the state's audited basic financial statements, is a requirement for receiving federal funds. It is our highest priority to ensure the state remains eligible to receive federal funding, meaning auditing this activity is a requirement. Moving to an annual Single Audit requires a transition period and we expect issuing of the first annual Single Audit over fiscal year 2026, by the federal deadline of March 31, 2027. We are proposing legislation to accommodate this transition which will require elimination of biennial audits of all state agencies in order to have the staff resources to complete such an audit.

After we dedicate adequate resources to completing the annual Single Audit and ACFR and related component unit audits, any remaining staff resources will be available for risk-based work. Risk-based work is audit work at agencies completed based on a perceived risk. Risks can be the result of new complex accounting standards, agency turnover, new legislation or computer systems, or non-routine transactions, to name a few. Risk-based work can also encompass activities that by their nature can result in fraud or errors such as use of procards, time reporting, travel, or agencies with a lack of segregation of duties.

We anticipate implementing an annual approach to identifying and prioritizing risk-based work which will have several layers. Our preliminary ideas on potential starting points for the risk-based work are discussed below, but we will refine these to ensure compliance with state law, if our proposed legislation passes in some form.

1. Initial procedures may include some type of data analysis at all state agencies. We currently have a base knowledge of all state agencies from the biennial audits we complete. To capitalize on that knowledge, annual analytics combined with a brainstorming meeting with management and all financial compliance staff to share knowledge about what we should expect or need to consider, could help us identify anomalies in activity as they occur.
2. We will consider identifying legislative interest in financial or compliance related topics. Recent examples include the massive federal funding for the pandemic, the new medical marijuana tax, or the increase in state tax revenue. Information could be gathered through post session

discussions, as well as discussions or surveys with relevant committees such as the Legislative Audit Committee, Senate Finance and Claims Committee, and Interim Budget Committees.

3. In lieu of a regular presence at all state agencies, surveying state employees about their financial and compliance related concerns could provide additional consideration on where the risks lie at particular agencies or the state as whole.
4. Hotline calls over time can demonstrate a pattern or trend, either statewide or at particular agencies. Trends such as a high volume of reports related to procards, travel, state car use, or reported time may indicate audit work over this activity at the statewide level is warranted. As part of our risk-based work, we may be able to assist with hotline call follow-up more frequently.
5. We likely will evaluate whether a traditional financial audit is warranted for certain agencies. For example, agencies headed by an elected official experience more frequent personnel and structural changes that can impact financial operations. As part of this, we anticipate we will need to consider a new financial schedule format to better meet legislator needs. We will seek input from the committee or other legislative members.
6. We will consider the need to confirm agencies are implementing the will of the Legislature. This can include appropriation related testing, such as evaluating agency use of statutory or restricted appropriations. It can also include testing compliance with new or amended state laws.
7. We will consider whether agency level internal controls should be evaluated to ensure all activity is recorded on the state's accounting system by fiscal year-end. This will require coordination with agencies. The presence of a regular biennial audit likely was considered a control at the agency level and agencies will need to replace that reliance with their own control practices. State law requires all financial activity to be recorded in accordance with Generally Accepted Accounting Principles (GAAP) by the end of the fiscal year. Without a presence at every state agency, we will have to perform some procedures to assure ourselves the state's accounting records are accurate and complete at fiscal year-end.
8. Lastly, there are two state laws specifically requiring the legislative auditor to report on an activity. This work was completed during our biennial agency audits. While these two laws are in effect, this work is still required and will be included in our risk-based work on a biennial basis, with reports issued prior to each legislative session. These laws require:
  - Review of internal service funds and whether fees are commensurate with costs and if the fund balance is reasonable (§17-8-101(6), MCA).
  - Evaluate whether state special revenue funds with only charges for services revenue have a cash balance that is more than twice their appropriation (§17-2-302(3), MCA).

Once the risk-based work is identified and prioritized, the type of engagement we complete will be determined. Under American Institute of Certified Public Accountants (AICPA) Professional Standards and *Government Auditing Standards*, there are several types of engagements we can complete such as agreed upon procedures, reviews, examinations, financial audits, or compliance audits. The subject matter and desired product will drive the type of engagement completed. Our transition efforts will include developing a decision-making process for identifying the appropriate type of engagement, developing standard programs and shell documents, and training our personnel on the requirements for each type. The proposed draft legislation will allow for any of these types of engagements.