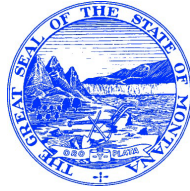


LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
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Deputy Legislative Auditors:
Cindy Jorgenson
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MEMORANDUM

TO: Members of the Legislative Audit Committee
FROM: Jennifer Erdahl, CPA, Financial-Compliance Audit Manager. *JLE*
DATE: September 29, 2022
RE: Financial-Compliance Next 50 Audit Model Analysis

The mission of the Legislative Audit Division is to increase public trust in state government by reporting timely and accurate information about agency operations, technology, and finances to the Legislature and the citizens of Montana. Our vision is to be the Legislature's most respected source for independent, accurate and reliable analysis that will make Montana a national leader in promoting government accountability.

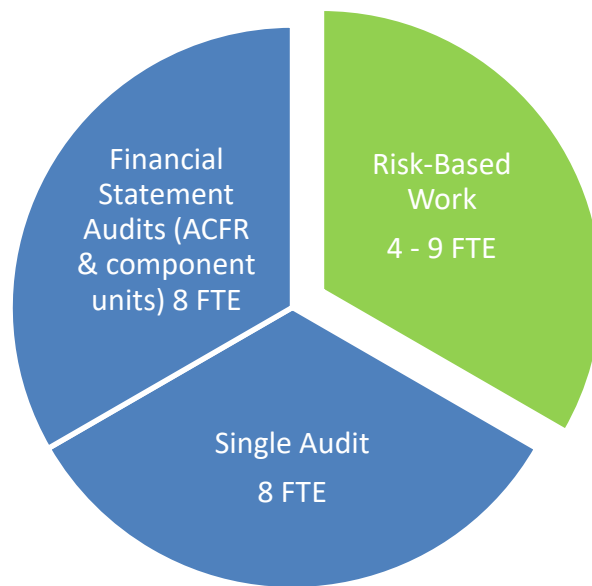
In the Financial-Compliance Function, we currently aim to fulfill our mission and vision by auditing in accordance with, §5-13-304, MCA, which requires an audit of every state agency on a biennial basis. We also complete an annual statewide (SWA) audit of the Annual Comprehensive Financial Report (ACFR) and a biennial Single Audit (SA) to comply with federal regulations. Under this model, some agency audits support either one or both of the ACFR and SA audits and others do not.

We are facing challenges meeting timeliness expectations for both ACFR and SA reporting, as a nationwide shortage of workers in the accounting field, the high cost of living in the Helena area, and shortage of affordable housing, makes hiring and retaining enough staff increasingly difficult. Additional testing required as a result of unprecedented federal funding in response to the pandemic has also brought to light the inflexibility of our current model. As part of the Next50 strategy, we have been looking at the structure of financial-compliance and the current audit model. This work, paired with the recent analysis by Eide Bailly, suggests the current model is no longer the best model for our office. We considered an annual audit of the ACFR, annual component unit audits, and a biennial Single Audit only model. We believe legislator and taxpayer needs are not fully served by that model. For this reason, we propose the financial-compliance team also document risk-based work at the agencies. We propose a change that would break our work into three sections as depicted below.



Such a change would require an amendment to state law(s) as well as consultation with our federal cognizant agent. If we move to an annual Single Audit, we estimate the earliest we could transition would be starting fiscal year 2026. Moving away from biennial audits of all state agencies to a risk-based approach could happen earlier pending consultation with our federal cognizant agent to ensure we maintain compliance with federal regulations during a transition period.

Of particular interest is the risk-based work. The number of hours available for this slice depends on the extent of resources needed for the recurring financial statement audits and Single Audit, including changes in audit and accounting standards. It will also depend on the scale and scope of the risk-based audit work the LAC wants to pursue. We believe there are significant financial, technological and operational risks in Montana state government that may receive some coverage under our current audit model and none under a model without a risk-based slice. The following figure illustrates the anticipated FTE allocations under a risk-based model that includes an annual Single Audit. Financial-compliance is allocated a total of 26 FTE, however, we currently have just 20 of these positions filled. The number of FTE available for risk-based work would be dependent on filled positions as the state or federally required financial statement and Single Audit work would take precedence. The 26 FTE includes the financial-compliance deputy. Her time is not considered in the chart below given the nature of the position.



While LAD staff are in agreement on moving to a risk-based approach for some of our work, a biennial vs annual single audit has not reached a similar consensus. Some of the key costs and benefits of such a change are noted below in relation to several different issues.

	<u>Cost</u>	<u>Benefit</u>
Financial Impact	Annual audits will cost more as the amount of work performed biennially cannot be substantially reduced on an annual basis.	Audit costs are already defined as allowable and can be charged to federal funds (existing law requires agencies to do so).

Timeliness	Agencies will need to adjust processes to meet annual March 31 Single Audit deadline.	Reporting will address the most recent period and will be up to date with current activity.
Findings Resolution	Increased audit frequency reduces the amount of time available for agencies to implement recommendations which could result in more repeat findings.	Increased audit frequency limits the amount of time non-compliance and associated costs affect programs.
Agency Resources	Agency staff will need to spend more time preparing for and assisting in audit work conducted annually.	Potential exists for process efficiencies as federal testing becomes a more routine and predictable activity.
Audit Coverage	More effort/hours will be expended as additional federal programs will likely be required to be audited. This will also decrease our ability to predict major programs as the window of time decreases from two years to one and more federal programs means less available time for risk-based work.	Audit coverage for major programs will expand to provide additional assurance over programs not audited before.
Peer Comparison	Less time to learn from experiences in other states, which can improve the efficiency and effectiveness of our testing.	Better adherence to nationally recognized best practices in the auditing profession.

We welcome discussion from the committee on the following decisions:

- Transition to annual Single Audits or retain biennial Single Audits. Annual Single Audits will require 4 more FTE than biennial Single Audits without other efforts to reduce workload.
- Transition to a risk-based approach for agency audits in lieu of the current biennial audits of each state agency. This will align our work with legislator and taxpayer needs, while also offsetting the increased FTE needs of a transition to annual Single Audits.
- Identification of required periodic/cyclical oversight of certain agencies (including elected officials), fund types, transaction activity, or other issues of specific legislative interest.