



MEMORANDUM

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TO: Members, Senate Ways and Means Committee
FROM: Scott Frank, Legislative Post Auditor
DATE: March 12, 2012
SUBJECT: Testimony Supporting House Bill 2414

I am appearing today in support of House Bill 2414. This bill would allow our office to charge state agencies for their share of the costs of the audit of the state's financial statements.

Background on the Statewide Single Audit

Current law requires audit work to fulfill both state and federal audit requirements. K.S.A. 46-1106 requires an audit of the state's financial statements (which are prepared by the Department of Administration and the Regents universities). In addition, the federal Single Audit Act mandates an audit of the federal funds state agencies spend. Taken together, these two components are known as the Statewide Single Audit.

Legislative Post Audit contracts with external auditors to conduct the Statewide Single Audit. Under current law, state agencies that spend federal funds pay for the cost of the federally required audit work. There currently are no provisions to charge agencies for the cost of the state-mandated audit work, so that is paid for out of Legislative Post Audit's appropriation.

Rationale for House Bill 2414

House Bill 2414 would allow our office to charge state agencies for their share of the costs of the state-mandated work. We requested this change for two primary reasons:

- **The audit of the state's financial statements is the only contracted audit work that is not paid for by the audited agency.** In addition to the Statewide Single Audit, we contract for a number of other audits, which are summarized in **Attachment A**. As the attachment shows, in almost every case, the audited agencies pay for the cost of the audits. The lone exception is the audit of the state's financial statements, which is an audit of the Department of Administration and the Regents universities, but is paid for by Legislative Post Audit.
- **The cost of the state-mandated audit work has been volatile in recent years, which has been difficult to budget for.** The increase in federal spending under the American Reinvestment and Recovery Act (ARRA), a change in the methodology used to allocate audit costs between state and federal requirements, and hiring a new audit firm have combined to make our share of the Statewide

Single Audit costs volatile in recent years. For example, the allocated cost of the state-mandated work was only \$156,000 in FY 2011. Conversely, our most recent estimate for FY 2012 is \$315,000 (about \$100,000 more than originally anticipated). The cause of this volatility is explained in more detail in **Attachment B**.

These variances are difficult to absorb in a budget of our size (approximately \$2 million). On the other hand, the two responsible agencies have much larger budgets (\$66 million for the Department of Administration and \$170 million for the Board of Regents). They would be in a much better position to handle \$50,000 to \$100,000 in volatility.

The Legislature did attempt to address this issue in 2010 but was unsuccessful. That year legislators introduced two measures to give Post Audit the ability to bill agencies for the cost of the state-mandated work:

- **The Legislature passed a one-year proviso in the FY 2011 budget bill that would have allowed Legislative Post Audit to charge agencies for the cost of the state-mandated audit work, but it was vetoed by Governor Parkinson.** The proviso in H Sub for SB 572 would have given our office this authority for one year. It was line-item vetoed by Governor Parkinson, primarily because he felt the Legislature already had sufficient funds within its budget to cover the audit costs.
- **The Senate passed Senate Bill 580, which would have given Post Audit the permanent authority to charge agencies for the state-mandated work, but it never passed the House.** The bill passed the Senate 40-0. However, it was late in the session and the bill was never heard in the House. The provisions of the current House Bill 2414 are based on 2010 Senate Bill 580.

Provisions of House Bill 2414

House Bill 2414 would require the Post Auditor to charge state agencies for the costs associated with the audit of the state's financial statements. We would anticipate charging the costs to two agencies—the Department of Administration for the audit of the general financial statements and the Board of Regents for the audit of the statements prepared by the Regents universities.

House Bill 2414 does not provide additional funding to the Department of Administration or the Board of Regents for these costs. Nor does it reduce Legislative Post Audit's appropriation. However, if the bill were to pass, our office would support transferring the \$288,000 we included in our Fiscal Year 2013 budget for the state-mandated audit requirements to the two agencies to pay for this new obligation.

Summary of Audit Contracts Administered by Legislative Post Audit	
Audit	Paid for By:
Statewide Single Audit <i>(State Financial Statements) (a)</i>	<i>Legislative Post Audit</i>
Statewide Single Audit <i>(Federal Expenditures)</i>	<i>Agencies that spend federal funds</i>
Financial Audit of the Department of Transportation	<i>Department of Transportation</i>
Financial Audits of the State (Water) Revolving Funds	<i>Department of Health and Environment</i>
Financial Audit of KPERS	<i>KPERS</i>
Financial and Security Audits of the Lottery	<i>Kansas Lottery</i>
Performance Audit of the State Treasurer	<i>State Treasurer's Office</i>
Performance Audit of the Pooled Money Investment Board	<i>Pooled Money Investment Board</i>
<p>(a) The state financial statements are prepared by the Department Administration. In addition, the audit covers the financial statements prepared by each of the six Regents universities.</p>	

Summary of Issues Related to the Statewide Single Audit Contract
Recent Instability in the Division’s Share of Those Costs

Legislative Post Audit contracts with outside auditors to conduct work that addresses both state and federal audit requirements. K.S.A. 46-1106 requires an audit of the state’s financial statements, and the federal Single Audit Act mandates an audit of federal funds state agencies receive. Under current law, state agencies that spend federal funds pay for the cost of the federally required audit work, while the cost of the state-mandated audit work is paid for out of Post Audit’s budget.

The following figure summarizes the Statewide Single Audit costs for the last several years:

Summary of Statewide Single Audit Costs Fiscal Year 2009 to 2012					
Fiscal Year	Audit Firm	Allocation Method (a)	State Financial Statements (paid by LPA)	Federal Requirements (paid by agencies)	Total Cost
2009	Joint Venture (b)	Total Expenditures	\$182,462 57%	\$137,138 43%	\$319,600 100%
2010	Joint Venture (b)	Total Expenditures	\$212,638 55%	\$175,326 45%	\$387,964 100%
2011	Joint Venture (b)	Audit Hours	\$156,372 22%	546,128 78%	\$702,500 100%
2012 (c)	RubinBrown	Audit Hours	\$315,000 55%	259,000 45%	\$574,000 100%

(a) Allocation by total expenditures means the federal share of the audit costs (%) is the same as the federal share of total spending (federal \$\$/total \$\$). Allocation by audit hours means the federal share of the audit costs (%) is the same as the federal share of audit hours (hours on federal requirements/total audit hours).

(b) The Joint Venture is a partnership that comprises two firms: Allen, Gibbs & Houlik (Wichita) and Berberich Trahan (Topeka).

(c) All amounts for Fiscal Year 2012 are based on the most current estimates.

As the figure shows, Post Audit’s share of the audit costs has fluctuated significantly in recent years. In 2010, our share increased to just more than \$212,000. That amount decreased significantly in 2011, to just more than \$156,000, but is expected to increase to almost \$315,000 for the current year. This recent instability can be attributed to three factors:

- 1. Because of the American Reinvestment and Recovery Act (ARRA), more programs have to be audited, significantly increasing the total cost of the audit.** Federal rules primarily require programs that spend large amounts of federal funding to be audited as part of the Statewide Single Audit. ARRA funding significantly increased the size of many programs to the point where they had to be audited. For example, of the 23 programs that were audited in Fiscal Year 2011, 10 were audited solely because of ARRA funding.

The additional audit work due to ARRA has significantly increased the cost of the Statewide Single Audit in recent years. The total cost of the audit was less than \$400,000 in both 2009 and 2010 (the two years prior to ARRA). In 2011, the cost nearly doubled to just more than \$700,000 (the primary year for ARRA funding). We estimate that in 2012 the audit will cost about \$574,000—less than in 2011 but far more than in previous years.

- 2. Beginning in Fiscal Year 2011, Post Audit changed its methodology for allocating the audit costs between the state and federal shares, significantly decreasing its obligation that year.** While the Statewide Single Audit has two components (state and federal) it is still one audit and the auditors bill us for both parts together. We then allocate the costs between the federal and state components, and bills the agencies who expend federal funds for their share of the audit. Historically, the allocation was on total expenditures of state and federal funds. In other words, if federal funds made up 45% of the state's total expenditures, then we would allocate 45% of the audit costs to the federal share.

During the 2010 session, the Senate Ways & Means subcommittee on legislative agencies removed all funding for the Statewide Single Audit from our budget, and directed us to bill all of the audit costs to state agencies. This involved two steps.

- First, members of the subcommittee directed us to change the basis for the allocation method from total expenditures to total audit hours. Because the audit work for the federal requirements involved more hours than the work for the state requirements, this meant more costs would be billed to agencies that spend federal funds.
- Second, the Legislature included a proviso that would allow us to bill state agencies for the state share. Although the proviso was line-item vetoed by the Governor, we went ahead and changed the basis for the allocation. As a result, our share of the audit costs decreased significantly, from almost \$213,000 in Fiscal Year 2010 to just more than \$156,000 in Fiscal Year 2011.

- 3. The new audit firm anticipates spending more audit hours on the state requirements, significantly increasing Post Audit's share of the costs.** From 2001 to 2010, the Statewide Single Audit contract was held by the Joint Venture of Allen, Gibbs and Houlik (Wichita) and Berberich Trahan (Topeka). However, in August 2010 the Contract Audit Committee (three LPAC members, the Post Auditor, and the Secretary of Administration) awarded the new three-year contract to RubinBrown, a regional accounting firm based out of St. Louis. While the overall cost of the audit will decrease in Fiscal Year 2012 (from about \$700,000 to an estimated \$574,000), our share of those costs will increase significantly (from \$156,000 to an estimated \$315,000).

Our estimated costs will increase because RubinBrown anticipates spending a far greater share of its audit time on the state audit work than the Joint Venture. Whereas the Joint Venture spent 22% of its audit hours on the state work in Fiscal Year 2011, RubinBrown expects to spend about 55% of its time on those requirements in Fiscal Year 2012. Because the state's share of the audit costs (which we pay) is based on audit hours, we will be responsible for more than half the total costs (compared with less than a quarter of the costs last year).