



MEMORANDUM

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TO: Members, House Committee on Federal and State Affairs
FROM: Scott Frank, Legislative Post Auditor
DATE: January 17, 2018
SUBJECT: Testimony Supporting House Bill 2441

I appreciate the opportunity to testify in support of House Bill 2441, which was introduced by the Legislative Post Audit Committee at our request. The bill would amend state law to reassign responsibility for procuring independent financial audits from the Legislative Division of Post Audit to the audited agencies.

Background Information

Legislative Post Audit was first created in 1971 to replace the previous State Auditor's Office. At that time, our office was responsible for conducting the state's financial audits. Within a few years, we also began conducting performance audits, and for about 10 years were responsible for both types of audits.

During the 1983 session, the Legislature reviewed the operations of Legislative Post Audit and determined the financial audits could be contracted out to certified public accounting (CPA) firms. The Legislature significantly downsized our office (from 38.0 FTE to 19.0 FTE). The financial audits were contracted out to CPA firms, and the remaining staff focused on performance audits. Our office's responsibilities with regard to financial audits was limited to overseeing the CPA contracts and conducting some limited audits of financial controls at smaller state agencies.

Legislative Post Audit is currently responsible for overseeing a total of five separate audit contracts. Most of the audits included in these contracts are required by statute, although some audits have been included for agency convenience. The five audit contracts are as follows:

- **Statewide Contract** – This is the largest contract and includes four statutorily required audits:
 - An annual audit of the state's consolidated annual financial report (CAFR)
 - An annual audit of the state's compliance with federal requirements (federal single audit)
 - Biennial examinations of financial management practices at the State Treasurers Office and the Pooled Money Investment Board.

Though not statutorily required, the statewide contract also includes annual financial audits of the Department of Transportation and two state revolving loan funds administered by the Department of Health and Environment.

- **KPERS Financial Audit** – This is a statutorily required annual audit of the financial statements prepared by KPERS.
- **Lottery Financial Audit** – This is a statutorily required annual audit of the financial statements prepared by the Kansas Lottery.
- **Lottery Security Audit** – This is a statutorily required triennial audit of the security controls in place at the Kansas Lottery.
- **911 Performance Audit** – This is a statutorily required triennial audit to evaluate the status of the state's 911 service implementation and whether moneys spent from the 911 grant fund have been used appropriately.

Our office is responsible for the five audit contracts with CPA firms, which involves the following:

- **Administer the invitation for bids (IFB) process on behalf of a the statutorily created Contract Audit Committee.** The Contract Audit Committee consists of five members—three members of the Post Audit Committee, the Secretary of Administration, and the Post Auditor. While the Contract Audit Committee makes the final decisions on which firms will be awarded contracts, we prepare and publish the IFB documents, solicit the bidders, and analyze the bids for the committee to review.
- **Negotiate and sign a final contract with each firm.** Although the fees are set by the bidding process, there are often smaller contractual issues that must be addressed before both parties sign the final contract.
- **Provide general oversight and management of each audit contract.** This includes actively monitoring the progress of each audit to ensure the key milestones and final deadlines are met. It also includes serving as an intermediary between the audit firms and agency management to help resolve communication issues or disputes.
- **Review the final audit report and supporting documentation to ensure the contractual requirements and applicable audit standards are met.** This helps ensure the state receives a quality audit from the audit firm.
- **Coordinate billings to the state agencies and payments to the audit firms.** Under state law, Legislative Post Audit contracts with the outside CPA firms for audit services, but the audited agencies are responsible for the costs of the audits. We prepare billing notices to the state agencies, collect the funds from those agencies, and make payments to the firms for their services.

Provisions of HB 2441

HB 2441 would transfer responsibility for procuring independent audits from Legislative Post Audit to the audited agencies. This would affect four of the five audit contracts we currently administer:

- **Statewide Contract** – The Department of Administration would take over responsibility for administering this audit contract. The audit firm would be selected by a new five-person Department of Administration Contract Audit Committee. The members of the committee would

be appointed by the Secretary of Administration, the Director of Accounts and Reports, the State Treasurer, the Director of the Division of Budget, and the Post Auditor.

- **KPERS Financial Audit** – KPERS would take over responsibility for administering this audit contract. KPERS Board of Trustees would be responsible for selecting the firm under its existing contracting process.
- **Lottery Financial Audit** – The Kansas Lottery would take over responsibility for administering this audit contract. The audit firm would be selected by a new three-person Kansas Lottery Audit Contract Audit Committee. The members of the committee would be appointed by the Executive Director of the Kansas Lottery, the Chair of the Kansas Lottery Commission, and the Post Auditor.
- **Lottery Security Audit** – Same as the Lottery financial audit.
- **911 Performance Audit** – No changes. Legislative Post Audit would remain responsible for all aspects of this audit contract. The current Contract Audit Committee would select the audit firm, and the cost of the audit would continue to be paid out of the Kansas 911 Fund.

Rationale for HB 2441

Removing responsibility for the financial audit contracts would allow us to focus on our service to the Legislature—conducting performance audits. While our office conducted both financial and performance audits at one time, for the past 35 years we have focused almost exclusively on performance audits. These are different types of audits which require different qualifications and skills. Specifically, financial audits require an extensive background in public accounting that our performance auditors do not typically possess. To provide proper oversight over the audit contracts, we have typically kept a single CPA on staff to manage the financial audit contracts. This person has typically worked on their own as a financial auditor, while the rest of our staff conducts performance audits. As a result, managing this function does not align well with our core mission and expertise.

On the other hand, the Department of Administration has a far more extensive accounting function that it can draw on. Having the accounting agency hire the independent auditor would be uncommon, but it would not be unprecedented. According to a 2017 survey conducted by the National Association of State Auditors, Comptrollers, and Treasurers (NASACT), 11 states contract entirely with CPA firms for outside audits of their financial statements and their compliance with federal requirements. These 11 states are shown in *Figure 1* on the following page. As the figure shows, eight of the 11 states, including Kansas, have a state auditor or a legislative audit committee select CPA firms to conduct these audits. However, three states—Massachusetts, Maryland, and New Jersey—have their state comptroller select the firm, which is similar to what we are proposing in HB 2441

Finally, having individual agencies such as KPERS or the Kansas Lottery hire their own auditors is far more common, and several other state agencies or authorities already do this. For fiscal year 2017, at least five “component units” of the State of Kansas had an independent audit conducted by a private CPA firm. (In public accounting, a component unit is a legally separate

organization for which the state is considered financially accountable.) The five component units included KPERS, the Kansas Lottery, the Kansas Turnpike Authority (KTA), the Kansas Development Finance Authority (K DFA), and the Kansas Housing Resources Corporation (KHRC). While Legislative Post Audit hired the independent auditors for KPERS and the Kansas Lottery, the other three component units hired their own auditors without any involvement from our office.

Figure 1 Firm Selection for the 11 States that Contracted for the Statewide Single Audit in 2017	
State	Audit Firm Selected By
Selected by State Auditor or Legislative Audit Committee	
Delaware	State Auditor
Hawaii	State Auditor
Kansas	Legislative Audit Committee
Nevada	Legislative Audit Committee
New York	State Auditor/Budget Office
Vermont	State Auditor
West Virginia	State Auditor
Wyoming	State Auditor
Selected by Agency	
Maryland	State Comptroller
Massachusetts	State Comptroller
New Jersey	State Comptroller/State Treasurer
Source: NASACT: <i>Auditing in the States (2017 Edition)</i>	

Budget Impact of HB 2441

HB 2441 would not directly affect the cost of the audit contracts or which agencies pay for them. Although the CPA contracts are with Legislative Post Audit, current law requires the audited agencies pay for the audits. That responsibility would not change under HB 2441.

However, under HB 2441, the Department of Administration would take on significant responsibilities to administer the statewide audit contract. These are primarily related to the part of the contract that covers the state’s compliance with federal requirements, and include ensuring the quality of the audit, as well as coordinating the payments from the state agencies covered by the federal audit. To give the department sufficient resources to administer the statewide contract, \$109,000 and 1.0 FTE would need to be transferred from Post Audit to the Department of Administration if HB 2441 were to pass. We will ask our budget subcommittees to flag this as an item to review at Omnibus.