

SHEMIA FAGAN

SECRETARY OF STATE

CHERYL MYERS

DEPUTY SECRETARY OF STATE

TRIBAL LIAISON



State of Oregon

900 Court Street NE #136

Salem, Oregon 97301

503-986-1500

<http://sos.oregon.gov>

HB2110 Testimony

Chair Grayber, Co-chair Lewis, Co-Chair Tran, and members of the Committee,

My name is Amy John and I'm an audit manager with the Secretary of State Audits Division. I am submitting my written testimony for the January 24th, 2023 public hearing on HB2110.

Municipal Audit Law (ORS 297.405-297.990) was compiled into its current form in 1941 and has worked relatively well, with some change, to promote accountability and transparency of local governments to their citizenry. The law requires Oregon's local governments to file an annual financial report and audit with our office. Audits are performed in accordance with professional standards by CPAs and Licensed Municipal Auditors, and in accordance with the Minimum Standards as established in Oregon Administrative Rules chapter 162. The reports submitted also include comments and disclosures related to the local government's compliance with certain state laws and rules (OAR 162-10 and OAR 162-40).

Local government spending more than \$500,000 a year are required to file a report that has been audited by a licensed municipal auditor. Local governments spending less than \$500,000 may be eligible to file a report that has been reviewed by a licensed municipal auditor, which is less in scope than an audit. If the local government spends less than \$150,000 during the year, they may be eligible to file a self-prepared report in lieu of audit. Counties and School districts are not eligible for this exemption and must file an audit report each year.

Periodically, revisions are needed in the law to reflect inflation, update terminology to better align with current practice and professional standards and adjust requirements to further the goal of improved transparency and accountability of local governments. As the program manager I have fielded many calls from auditors and municipalities requesting amendments to the law and asking for clarification or assistance where the current statutes might be unclear or outdated.

House Bill 2110 proposes the following to address these needed and requested changes:

1. Increase in thresholds for audit exemption that dictate the type of report that may be filed;
2. Replace Review reports with targeted Agreed Upon Procedures (AUP) reports; and
3. Remove the provision to withhold certain state funding from counties or cities that do not file on time.

Increase Report Type Thresholds

All entities are subject to filing an annual financial report and an audit. The law provides an exemption from audit for smaller governments; those spending less than \$500,000 may file a review report and

SHEMIA FAGAN

SECRETARY OF STATE

CHERYL MYERS

DEPUTY SECRETARY OF STATE

TRIBAL LIAISON



State of Oregon

900 Court Street NE #136

Salem, Oregon 97301

503-986-1500

<http://sos.oregon.gov>

those spending less than \$150,000 may file a self-prepared report in lieu of audit. HB2110 proposes to increase these thresholds from \$150,000 and \$500,000 to \$250,000 and \$1,000,000.

It has been almost 20 years since the thresholds were adjusted. Inflation and increased spending has resulted in many smaller entities now needing to hire a licensed municipal auditor to audit or review their annual report, at significant cost.

It's important to point out the impact that raising the thresholds will have on local governments. First, 99% of all local government spending will still be subject to audit requirements. Second, nearly half of the local governments will remain subject to audit.

Replace Review Reports with Agreed Upon Procedure Engagements (AUP)

HB2110 proposes to replace the review report with an Agreed Upon Procedures engagement, or AUP.

Currently, most entities that spend between \$150,000 and \$500,000 annually are eligible to submit a financial report that has been reviewed by a licensed municipal auditor. A review is less in scope than an audit and includes inquiry and analytical procedures; the detailed testing and rigorous risk assessment required in an audit is not required for reviews

Transparency and accountability are at the core of Municipal Audit Law, and the Oregon Minimum Standards emphasize consistent financial reporting and compliance. Minimum Standards for review in Oregon (OAR 162-010) require local government officials sign a statement representing the government's compliance, or non-compliance, with certain requirements and fiscal affairs (OAR 162-040-0096); for example, compliance with investment rules, local budget law, and use of State highway funds. In over 10 years with the program, I have yet to see a representation that discloses non-compliance in a review report.

In order to improve accountability and the assurances made to the public, we're proposing a revision to this mid-level report option. This is particularly timely as the reporting threshold increase is being considered.

Agreed-upon procedures are governed generally by professional standards and will be performed by a licensed municipal auditor. What will look different is that specific minimum procedures required to be performed and reported on would be developed in cooperation with the Oregon Board of Accountancy, the Oregon Society of CPAs, and the municipal audit community. Procedures will specifically target the operations, risks, and compliance requirements of Oregon's municipalities and will be maintained in

SHEMIA FAGAN

SECRETARY OF STATE

CHERYL MYERS

DEPUTY SECRETARY OF STATE

TRIBAL LIAISON



State of Oregon

900 Court Street NE #136

Salem, Oregon 97301

503-986-1500

<http://sos.oregon.gov>

Oregon Administrative Rules. Representations regarding compliance will be supported by the procedures performed by the licensed municipal auditor.

We expect the AUP reporting will better target each government's operations, compliance, and risks. The result will be more informative and transparent reports for local governments and the public, directly identifying issues that need addressed through operational changes or improved compliance.

Remove ineffective withholdings provision

Cities and counties that do not file on time (within 6 months from the end of the fiscal year) are subject to 10% withholding of certain state funds otherwise due, including highway funds, cigarette tax, and the state revenue share. The funds withheld are distributed to the local government only after the required reports are filed; none of that amount is kept as a fine or to cover administrative costs of the Secretary of State, Department of Administrative Services, or the Oregon Department of Transportation. For cities and counties that become subject to withholdings, the outcome is typically not one that encourages compliance: at best it is an inconvenient cash flow problem, and at worst it can contribute to the government's challenges to complete their annual audit.

Since the withholding provision was implemented in 2017 (as a result of 2015 legislation) it has not resulted in increased compliance or more timely reporting. This sanction is ineffective and does not warrant the administrative costs.

In summary, I encourage you to support HB2110 which proposes to increase filing thresholds for audit exemption, replace review reports with AUP reporting, and remove the ineffective withholding provision for cities and counties that do not file on time.

Thank you,

Amy John, CPA, Secretary of State Municipal Audit Manager