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## **HB 2110 A Testimony**

Chair Taylor, Vice-Chair Bonham, and members of the Committee,

My name is Amy John and I'm the Municipal Audit Manager with the Secretary of State Audits Division. I am submitting my written testimony for the March 2, 2023 public hearing on HB 2110 A.

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 the public. 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 who are also Licensed Municipal Auditors, and with the Minimum Standards as established in Oregon Administrative Rules chapter 162. (OAR 162-10 and OAR 162-40)

Currently, all local governments are subject to annual audits but may be eligible for an audit exemption and instead file a self-prepared report or a financial statement review performed by a CPA.

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.

House Bill 2110-A proposes the following changes.

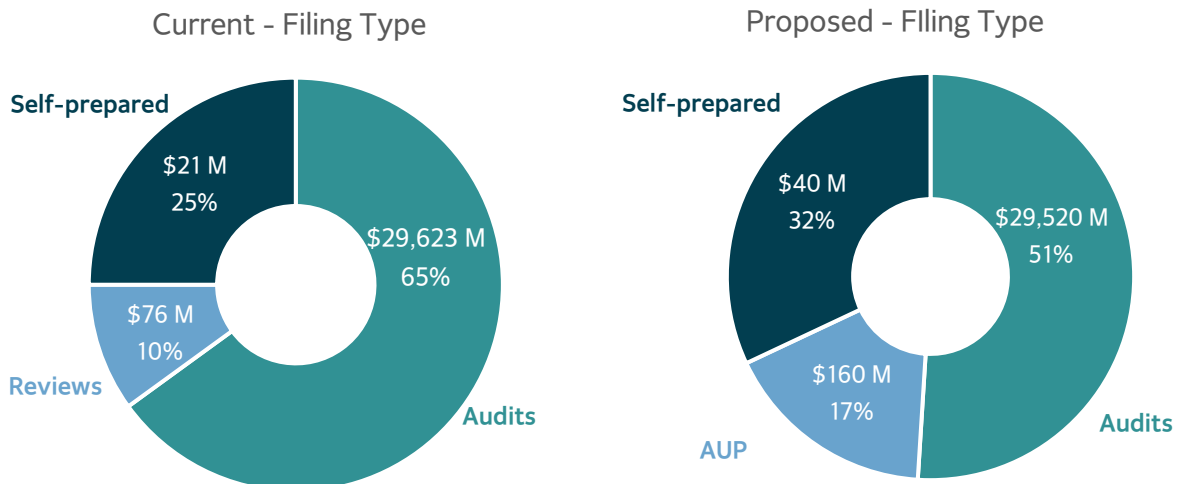
1. Increase the thresholds for audit exemption;
2. Replace Review reports with targeted Agreed Upon Procedures (AUP) reports;
3. Remove the provision to withhold certain state funding from counties or cities that do not file on time;
4. Increase annual filing fees;
5. Update and clarify definitions;
6. Remove the Municipal Auditor License fee amount, giving the Oregon Board of Accountancy more complete regulatory oversight; and
7. More clearly define terms and remove outdated or unnecessary language

## Increase Reporting Thresholds

It has been almost 20 years since the thresholds were adjusted. Inflation and increased spending have resulted in many smaller entities now needing to hire a CPA to audit or review their annual report, at significant cost. The table below depicts the current and proposed thresholds and types of reporting.

Filing Type	Local government spending	HB2110 Thresholds
Audit*	> \$500,000	> \$1,000,000
Review/AUP	\$150,000 - \$500,000	\$250,000 - \$1,000,000
Self-prepared	= < \$150,000	= < \$250,000

The impact on local governments is reflected below: Seven percent (7%) of the entities currently required to engage with a CPA will no longer be required to. However, two-thirds of local governments will still be required to engage with a CPA to perform an audit or Agreed Upon Procedures. Over half of all local governments and over 99% of the dollars in Oregon will remain subject to audit requirement, the highest level of assurance.



## Replace Review Report with Agreed Upon Procedures Reporting

HB 2110 A proposes to replace the review report with an attestation engagement, specifically Agreed Upon Procedures (AUP). A review is less in scope than an audit and includes primarily inquiry and analytical procedures; the detailed testing and rigorous risk assessment required in an audit is not required in a review engagement.

The reason this change is being proposed is because transparency and accountability are at the core of Municipal Audit Law. The Oregon Minimum Standards emphasize consistent financial reporting and compliance. Changing the type of engagement performed by a CPA will improve accountability and information provided to the public.

For example, the 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). These “certain” items may include compliance with investment rules, local budget law, and the use of State highway funds. In over 10 years with the program, I can’t recall seeing a representation that disclosed non-compliance in a review report. In a review report the CPA performs inquiries and analysis related to the local government financial reporting but is not required to perform testing or a review of compliance; the review report engagement provides what auditors call “limited assurance.”

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

AUP engagements are governed generally by professional standards and will be performed by a CPA who is a licensed municipal auditor (CPA). The AUP report will be submitted along with the annual financial report, the same as with a review report. What will look different is that specific minimum procedures will be required by the CPA. The CPA will report the results of procedures performed providing increased, independent accountability. Procedures will target the operations, risks, and compliance requirements of Oregon’s local governments and will be maintained in Oregon Administrative Rules.

Procedures will be developed in cooperation with the Oregon Board of Accountancy, the Oregon Society of CPAs, and the municipal audit community. Procedures may include confirming cash balances, reviewing the existence of specific controls (like timely cash reconciliations), and testing compliance with certain laws and rules.

We expect 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**

Untimely filing by cities and counties subjects them to 10% withholding of certain state funding, including highway funds and the state revenue share. This is not a penalty but is a delay in payment. 100% of withheld funds are distributed after the required report is filed. State agencies do not keep any portion to cover administrative costs, specifically the Department of Administrative Services and Oregon Department of Transportation.

The withholding provision was enacted during the 2015 legislative session as a mechanism to deter late filing. While that is a worthy intent, it has not been the result. For cities and counties, this becomes a cash flow issue and can actually contribute to the government’s challenges to complete their annual audit.

The average amount withheld each month was about \$1500 for cities and \$12,400 for counties. Withholdings were as low as \$153 per month for a small city.

Since the withholding provision was implemented, it has not resulted in increased compliance or more timely reporting. This sanction is ineffective and does not warrant the administrative costs. Removing the provision allows us to reconsider what might be a more effective tool.

### **Increase annual filing fee paid by local governments**

The current filing fees enabled in ORS 297.485 have been in statute since at least 1999. These fees provide approximately \$335,000 annually and are designated for the Municipal Audit Program. The fee increase would result in a total of approximately \$460,000 annually. With inflation, increased costs, and additional program requirements, the Division is requesting the fee increase to continue providing necessary program administration and services.

We propose to increase filing fees that range from \$20 to \$400 with filing fees that range from \$40 to \$500.

### **Updating Terminology and General Cleanup**

HB 2110 A will also better align with professional accounting and auditing standards:

1. Remove the specific fee amount for the Municipal Auditor License (which specifies a “not to exceed” amount that has not kept up with inflation), giving the Oregon Board of Accountancy more complete regulatory oversight of the license; and
2. More clearly define terms to assist with compliance and remove outdated, redundant, or unnecessary language.
3. Repeal outdated and unused provisions allowing audit reports to be completed by federal auditors and requiring county reports to be mailed to the Department of Revenue.
4. Specific revisions as outlined in the table submitted with this testimony.

**In summary, I encourage you to support HB 2110 A 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  
Audit Manager