

BEFORE THE DEPARTMENT OF ADMINISTRATION
OF THE STATE OF MONTANA

In the matter of the amendment of)	NOTICE OF AMENDMENT AND
ARM 2.4.401, 2.4.402, 2.4.403,)	REPEAL
2.4.404, 2.4.405, 2.4.406, 2.4.409,)	
2.4.410, and 2.4.411 pertaining to)	
accounting and financial reporting)	
standards, report filing fees, filing)	
penalties, waivers and extensions of)	
penalties, audit and audit reporting)	
standards, the roster of independent)	
auditors, resolution and corrections of)	
audit findings, financial reviews, and)	
incorporation by reference of various)	
standards, accounting policies, and)	
federal laws and regulations and the)	
repeal of ARM 2.4.408 pertaining to)	
audit contracts)	

TO: All Concerned Persons

1. On June 21, 2019, the Department of Administration published MAR Notice No. 2-4-581 pertaining to the public hearing on the proposed amendment and repeal of the above-stated rules at page 761 of the 2019 Montana Administrative Register, Issue Number 12. On July 26, 2019, the department published the amended notice of proposed amendment and repeal at page 987 of the 2019 Montana Administrative Register, Issue Number 14.

2. The department has thoroughly considered the comments and testimony received. A summary of the comments received and the department's responses follow:

Comments #1 through #8 relate to ARM 2.4.401:

COMMENT #1: Commenters requested that the department use the term "local government entities" as defined in 2-7-501, MCA, instead of "special purpose districts," because the term "special purpose district" could be confused with special districts internal to a county, city, or town (e.g., assessment districts).

RESPONSE #1: The department agrees using the term "local government entities" instead of "special purpose districts" provides additional clarity.

COMMENT #2: Multiple commenters expressed support for allowing smaller local government entities to use the Small Government Financial Reporting Framework (SGFRF).

RESPONSE #2: The department appreciates all comments received during the rulemaking process.

COMMENT #3: Some commenters requested confirmation that the Governmental Accounting Standards Board (GASB) compliance requirement in ARM 2.4.401(1) will not apply to local government entities that qualify for and choose to use the SGFRF. These commenters suggested adding "Except as provided in (2)" at the beginning of ARM 2.4.401(1) to differentiate between the rule of general application in (1) and the exception in (2).

RESPONSE #3: The department confirms the GASB compliance requirement in ARM 2.4.401(1) will not apply to local government entities approved to use the SGFRF. The department agrees the suggested modification will provide clarity and is amending ARM 2.4.401(1) accordingly.

COMMENT #4: Commenters, including the initial bill sponsor, requested that the department increase the population limit for a local government entity to be eligible to use the SGFRF to a population of 5,000 or less. Commenters contend entities with population of 5,000 or less are relatively small, have small budgets, and have resource difficulties similar to the entities the department originally proposed including in the SGFRF. Given the similarities, these entities should be eligible to use a framework that will save them money, reduce issues of training and retention, and streamline the financial reporting process.

RESPONSE #4: The department agrees and has amended the rule and the SGFRF to increase the population limit to 5,000 or less.

COMMENT #5: Some commenters opposed the proposed SGFRF application requirement. The commenters proposed striking the application requirement and allowing all local government entities with a population of 5,000 or less to use the SGFRF if they choose. They consider the application requirement unnecessary, bureaucratic, and time-consuming.

RESPONSE #5: The department disagrees that the SGFRF application is unnecessary. The application process is necessary to ensure consistent and comparable financial reporting by controlling the frequency of framework changes. If a local government entity switches frameworks frequently, the year-to-year financial statements will not be comparable and, therefore, will lack usefulness in terms of their ability to demonstrate accountability. Also, the application provides the department the ability to reject an application if it is known to the department that the local government entity is subject to a requirement to issue financial statements in accordance with Generally Accepted Accounting Principles. Such requirements are often provided through state and federal grant and loan programs but also may be provided in statutes related to specific entity types, such as school districts. The application process also allows the department to address specific provisions in audit standards regarding the auditor's assessment of the appropriateness of a financial reporting framework and the auditor's classification of low-risk entities. For

example, without the control provided by the application approval process, auditors conducting audits in accordance with federal regulation (2 CFR 200) will be required to classify those local government entities as high-risk entities (2 CFR 200.520). As a result, the auditor will be required to perform procedures on twice as much (i.e., from 20 percent to 40 percent - 2 CFR 200.518(f)) of those entities' applicable federal expenditures. This would increase audit costs unnecessarily for those entities.

COMMENT #6: Some commenters asked the department to directly adopt the SGFRF standards into the rules and not incorporate them by reference because direct adoption could improve clarity and transparency.

RESPONSE #6: The department agrees and has adopted the provisions of the SGFRF at ARM 2.4.401(2) and (3) and removed the incorporation by reference from ARM 2.4.411.

COMMENT #7: Commenters questioned whether the proposed rules should include requirements for SGFRF audit contracts when a local government entity issues audited SGFRF financial statements.

RESPONSE #7: The department does not believe the rules should be amended to address SGFRF audit contracts because the department does not have rulemaking authority regarding audit contracts.

COMMENT #8: Commenters asked the department to address whether it plans to proceed with verbal indications that the auditor for a local government entity will now be required to do the GASB statements for the entity. If so, the commenters ask the department to incorporate those requirements into the ARM and explain the reasonable necessity for the requirements. The commenters argue this will add another layer of unnecessary, costly, time-consuming, and bureaucratic requirements that will further exacerbate the challenge of finding and retaining qualified accountants and auditors.

RESPONSE #8: The department does not plan to require auditors to prepare financial statements for local government entities. Such a requirement would not be proper given that it could potentially impair auditor independence.

Comment #9 relates to ARM 2.4.403:

COMMENT #9: Some commenters sought to confirm the department proposed deleting ARM 2.4.403(1) because it duplicates 2-7-517(4), MCA.

RESPONSE #9: The department confirms it deleted ARM 2.4.403(1) because it needlessly repeated 2-7-517(4), MCA.

Comment #10 relates to ARM 2.4.403 and 2.4.404:

COMMENT #10: Some commenters recommended the department combine ARM 2.4.403 and 2.4.404 into one rule to streamline the administrative rules.

RESPONSE #10: The department considered combining the two rules; however, after review, the department determined the change could create confusion regarding the differences between the penalties in the two rules.

Comments #11 through #13 relate to ARM 2.4.405:

COMMENT #11: Some commenters suggested adding "except as provided in (2)" at the beginning of ARM 2.4.405(1).

RESPONSE #11: The department does not agree with the suggestion because it would create an inappropriate exception to federal audit requirements. The exception would cause the entity to be noncompliant with federal regulation (2 CFR 200).

COMMENT #12: Commenters hoped the department would work with other state agencies that use GAAP compliance language in their contracts and their federal agency partners, if necessary, to help them understand the changes and assist in creating alternative language that allows local government entities, where possible, to use SGFRF and still be eligible for state and federal grants, loans, and other funding. These commenters argued this is a critical piece of the success of SGFRF as a relief for smaller local governments, nearly all of whom have some type of infrastructure funding agreement with a Montana state agency for state or federal grants or loans.

RESPONSE #12: The department plans to continue to provide awareness about the administrative and regulatory options available to state agencies as a result of the new SGFRF through correspondence, newsletters, and other direct communications.

COMMENT #13: Some commenters requested clarification about whether the SGFRF will be available to communities that qualify for the SGFRF but also receive a federal grant, loan, or other funding award. Commenters asked the following questions. "Is this simply a matter of whether the contract reflects the appropriate accounting standards in the contract with the federal agency? If SGFRF will not be available to any local government entity that receives a federal award, how long will that prohibition last? Is there a possibility that there are particular federal award auditing and reporting standards that can be used, so that SGFRF can continue to be used but supplemented with the necessary reporting and auditing information pertaining to items relevant to the federal award?"

RESPONSE #13: These comments exceed the scope of the proposed rulemaking because the proposed rules did not, and could not, address these topics. The answers to these questions will depend on the requirements of other programs and the specific circumstances of each situation. The department recommends local

government entities communicate with their specific grant or loan program administrators to discuss their reporting requirements and the potential implications of reporting in accordance with the SGFRF.

Comments #14 through #21 relate to ARM 2.4.409:

COMMENT #14: Several commenters questioned whether the terms "corrective action plan" and "planned corrective measure" refer to the same requirement. Commenters noted that 2-7-515(1), MCA, requires a local government to submit a "corrective action plan" that details what action or actions they plan to take on any findings or recommendations contained in the audit report. Existing ARM 2.4.409(1) uses similar language. The proposed amendments to ARM 2.4.409 refer only to "planned corrective measures."

RESPONSE #14: The terms are not interchangeable. The "corrective action plan" is the local government entity's submission to the department that includes the entity's "planned corrective measures."

COMMENT #15: Multiple commenters request a 180-day deadline before publication of delinquent audit responses on the department's website. Commenters argue publication of delinquent audit responses should align with ARM 2.4.403, which provides that publication of delinquent audit reports occurs 180 days after the statutory deadline.

RESPONSE #15: The department disagrees that there should be coordination between the two publication requirements because the risks and facts of the two requirements are different. Section 2-7-517, MCA, provides that if a financial report or audit is not filed with the department within 180 days of the dates set forth in 2-7-503, MCA, the department shall provide public notice of the delinquent audit or report. Section 2-7-515(1), MCA, on the other hand, mandates that within 30 days following receipt of an audit, a governing body of each audited local government entity shall in writing notify the department what action it plans to take on any recommendation or deficiency. The department believes that given this 30-day mandate, the legislature intended that the department notify the public of the delinquency within a much quicker timeframe than the 180-day period. If the department implemented the 180-day request, it would allow too much time to elapse between the time the local government learned of the audit finding and the public's eventual awareness that the local government is delinquent in responding to it, which is not in the public interest.

COMMENT #16: Commenters requested that ARM 2.4.409(2) be reordered or restructured to reflect that rejecting a recommended measure or taking no corrective measure may also be an acceptable response to a noted deficiency in an audit or financial review report. The commenters argued 2-7-515(2), MCA, allows a local government entity to reject noted deficiencies or proposed recommendations for improvement.

RESPONSE #16: The department agrees the rule should be amended and reordered to clarify that a local government entity may reject a finding or recommendation for improvement as a response to a noted deficiency in an audit or a financial review report. As such, the department amended (1) and (2) to clarify that the entity may submit to the department a response or planned corrective measures. The department also reordered (2) and (3) from the previous proposal to state that responses or planned corrective measures will be first evaluated against the risks, facts, and circumstances of the findings and of the entity before the department determines whether planned corrective measures are responsive to and provide for a probable resolution of a finding.

COMMENT #17: Commenters request that the department provide detail regarding the internal process the department will follow in determining acceptableness of the local government entity's planned corrective measures. The commenters argue because Senate Bill 302, L. 2019, includes penalties and potential legal liability for failing to resolve significant audit findings or implement corrective measures, which implicates a discretionary determination that will involve a weighing of the evidence and findings being made, the process the department engages in when making a final determination should be transparent, understandable, and provide due process.

RESPONSE #17: The commenters' request is beyond the scope of the proposed rule amendments and cannot be done in a final rule notice because parties will not have had a chance to comment on the details regarding the internal process if implemented in this final notice; however, the department may consider this request in a future proposal.

COMMENT #18: Some commenters asked the department to define the term "significant" as used in 2-7-515, MCA, as amended by SB 302. The commenters request additional bounds on the department's discretion to determine significance of findings that pose a risk to the entity of ongoing concern, significantly distressed operations, or a failure to protect a substantial public interest. Also, the bill sponsor of Senate Bill 302, L. 2019 expressed concern that the department should not consider late report submission findings significant and should not equate such findings with other findings of noncompliance.

RESPONSE #18: The department has qualified circumstances it considers "significant" in (5). In response to the comment, the department has changed (5) to better describe circumstances that could lead to a determination that a finding is significant. The significance of findings will be based on risks to the entity of a doubtful going concern, significantly distressed operations, and a failure to protect a substantial public interest. The department considered but ultimately rejected commenters' suggestion to add a qualifier regarding "a risk to the entity of ongoing concern," because this language is not commonly used in the accounting and auditing profession and may lead to confusion. The department confirms it will not classify late reporting findings as significant.

COMMENT #19: Two commenters suggested deleting provisions subjecting findings of financial reviews to the same process as audits. Commenters contend the department does not have statutory authority to apply the process used for audit findings to financial review findings because 2-7-515, MCA, expressly refers to findings identified in audits and does not expressly refer to findings identified in financial reviews. In addition, SB 302 did not address or affect financial review findings.

RESPONSE #19: The existing language of ARM 2.4.410(11), renumbered (8), provides: "The provisions of 2-7-522, MCA, regarding audit report reviews by the department apply to financial review reports." This provision existed in rule prior to being transferred to the department from the Department of Commerce in 2002, and it falls within the department's broad rulemaking authority regarding financial review reports in 2-7-503, MCA. Although the department does not agree with commenters' rationale for removing references to financial review reports from (1) and (8) of ARM 2.4.409, the department deleted the references to avoid unnecessarily repeating the material found in ARM 2.4.410.

COMMENT #20: Noting that SB 302's amendment of 2-7-515, MCA, provides for a conference between the local government entity and the department if the department rejects the entity's proposed corrective measures, some commenters asked the department to add language addressing this process at the beginning of ARM 2.4.409(4).

RESPONSE #20: While the department recognizes and has historically implemented the statutory requirement for a conference when the department and local government entity do not agree as to the entity's proposed corrective measures, the department does not agree to add the commenters' proposed language to the rule because it would unnecessarily duplicate the requirement in 2-7-515, MCA, as amended. The statutory requirement is clear, and pursuant to 2-4-305(2), MCA, rules may not unnecessarily repeat statutory language.

COMMENT #21: Multiple commenters request a good cause exception to withholding financial assistance upon the first occurrence of a significant finding similar to the good cause exception allowed when a finding is repeated in a subsequent audit report. The commenters express concern that the rules do not describe when or why financial assistance might be withheld upon an initial significant finding.

RESPONSE #21: The department agrees to provide a good cause exception for the first occurrence of a significant finding in addition to the previously proposed exception for subsequent repetitions of a finding. Accordingly, the department has amended the rule so that it is no longer specific to the repetition of findings. In addition, the department moved (8)(a), (b), and (c) to new (9), (10), and (11) to enhance readability.

GENERAL COMMENTS:

COMMENT #22: Commenters encouraged the department to further streamline the Single Audit Act rules and to adopt rules that maximize the benefits of simpler accounting standards and processes for small local government entities.

RESPONSE #22: The department will continue to engage with local government entities to streamline the rules while continuing to meet the needs of other stakeholders that provide resources to local governments, including local taxpayers, state agencies, and federal entities. In this rulemaking, the department removed rules that unnecessarily duplicated statutes, avoided proposing rules that would overly complicate the rules, and removed provisions that were unnecessary or outdated. While the department cannot make significant amendments to the rules in this final notice, it encourages the commenters to submit their specific proposals to the department for possible incorporation in a future rulemaking.

COMMENT #23: Some commenters contend there are less resources available to smaller local government entities, citing relocation of field office staff to Helena and the loss of two employees who were familiar with local government accounting and auditing standards.

RESPONSE #23: This comment exceeds the scope of this rule proposal. The commenters are encouraged to contact the department for further explanation or assistance.

3. The department has amended the following rules as proposed: ARM 2.4.402, 2.4.403, 2.4.404, 2.4.405, 2.4.406, and 2.4.410.

4. The department has repealed the following rule as proposed: ARM 2.4.408.

5. The department has amended the following rules as proposed, but with the following changes, new matter underlined, deleted matter interlined:

2.4.401 ACCOUNTING AND FINANCIAL REPORTING STANDARDS

(1) ~~All counties, cities, towns, and special purpose districts, other than school districts and special education cooperatives,~~ Except as provided in (2), all local government entities, as defined by 2-7-501(7), MCA, shall adhere to the accounting and financial reporting standards applicable to the reporting period adopted by the Governmental Accounting Standards Board (see ARM 2.4.411).

(2) If approved by the department, a local government entity shall adhere to the provisions described in the Small Government Financial Reporting Framework instead of the provisions provided in (1) ~~(see ARM 2.4.411).~~ The department shall not approve an application to report in accordance with the Small Government Financial Reporting Framework if the following circumstances are known to the department:

(a) the local government entity is subject to a compliance requirement prescribing the use of the provisions of (1); or

(b) the local government entity has a population of 5,000 or more as reported in the most recent decennial survey issued by the United States Census Bureau.

(3) The reporting provisions of the Small Government Financial Reporting Framework include:

(a) all aspects of accounting and reporting in accordance with generally accepted accounting principles, updated through June 30, 2019, as defined by the Governmental Accounting Standards Board, or its successor, excluding the following:

(i) the government-wide statement of net position and the government-wide statement of activities, which also excludes:

(A) reporting of discretely presented component units;

(B) reconciliations related to the government-wide statements; and

(C) notes related to the government-wide financial statements;

(ii) actuarially determined post-employment benefit information, which also excludes:

(A) recognition of non-employer contributions;

(B) related notes to the financial statements; and

(C) related required supplementary information;

(iii) the following supplementary information required by the Governmental Accounting Standards Board:

(A) the management's discussion and analysis;

(B) certain revenue and claims development information of public entity risk pools; and

(C) the schedules of assessed condition and estimated and actual maintenance and preservation costs for the modified approach for infrastructure assets;

(b) financial statements must include as basic financial statements:

(i) a statement of changes in governmental capital assets; and

(ii) a statement of changes in governmental long-term debt;

(c) financial statements must include major fund budgetary comparison information, including related required notes, as supplementary information, as defined by the Governmental Accounting Standards Board, when applicable; and

(d) financial statements must include the schedules of proportionate shares and required contributions, excluding related notes, prepared for the local government entity by the Montana Public Employee Retirement Administration and the Montana Teachers' Retirement System as other information, when applicable.

2.4.409 ACTIONS BY GOVERNING BODIES TO RESOLVE OR CORRECT AUDIT FINDINGS AND PENALTY FOR FAILURE TO DO SO

(1) If a local government entity does not submit its responses or planned corrective measures to findings reported in audit and financial review reports required by Title 2, chapter 7, part 5, MCA, to the department within 30 days of the report issuance date, the department shall notify the entity of the delinquency and publish notice of the delinquency on the department's website.

(2) The planned corrective measures must be responsive to the findings identified and provide for a probable resolution of the findings within a reasonable period.

~~(3) The department shall base a determination of the acceptableness of the local government entity's planned corrective measures on the risks, facts, and circumstances of the findings and of the entity.~~

(2) The department shall determine acceptability of the local government entity's responses or planned corrective measures based on the risks, facts, and circumstances of the findings and of the entity.

(3) The planned corrective measures must be responsive to the findings identified and provide for a probable resolution of the findings within a reasonable period.

(4) remains as proposed.

(5) The department shall ~~base~~ determine the significance of findings based on the risks to the entity of a doubtful going concern, significantly distressed operations, or ~~substantially unprotected public interest~~ a failure to protect a substantial public interest.

(6) and (7) remain as proposed.

(8) If the subsequent audit ~~or financial review~~ report repeats a significant finding, the department shall withhold financial assistance from the entity.

~~(a) (9)~~ (9) The financial assistance withholding process may be ~~halted~~ suspended if the entity demonstrates good cause for the ~~repeat finding~~ failure to resolve the finding or implement corrective measures. Good cause may be demonstrated with sufficient evidence of:

(i) through (iii) remain as proposed but are renumbered (a) through (c).

(b) and (c) remain as proposed but are renumbered (10) and (11).

(9) remains as proposed but is renumbered (12).

2.4.411 INCORPORATION BY REFERENCE OF VARIOUS STANDARDS, ACCOUNTING POLICIES, AND FEDERAL LAWS AND REGULATIONS (1) remains as proposed.

~~(2) The department adopts and incorporates by reference the Small Government Financial Reporting Framework established by the department as of June 30, 2019, as provided by ARM 2.4.401, available at <https://sfsd.mt.gov/LGSB>.~~

~~(a) The framework defines an alternative basis of accounting to generally accepted accounting principles for small governments to use for financial reporting and auditing purposes. This alternative basis of accounting excludes some of the more complex accounting calculations and disclosures required by generally accepted accounting principles as immaterial for a small government.~~

~~(3) (2)~~ (2) The department adopts and incorporates by reference the Government Auditing Standards, 2011 and 2018 revisions, established by the Comptroller General of the United States, as provided by ARM 2.4.406.

(a) Government Auditing Standards incorporated by reference in ~~(3) (2)~~ (2) contain standards to be followed by an independent auditor in conducting financial audits of local government entities, including general standards, field work standards, and reporting standards.

(4) and (5) remain as proposed but are renumbered (3) and (4).

By: /s/ John Lewis
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By: /s/ Michael P. Manion
Michael P. Manion, Rule Reviewer
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Certified to the Secretary of State November 26, 2019.