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# Senate

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State of Minnesota

FROM: Stephanie James, Senate Counsel (651/296-0103)

DATE: February 4, 2019

RE: Former State Auditor Otto's Lawsuit Involving Counties' Use of Private Auditors

On February 4, 2016, the State Auditor brought a lawsuit challenging the constitutionality of a 2015 change in state law<sup>1</sup> regarding the State Auditor's role in conducting financial audits of Minnesota counties. The lawsuit related to the scope of the State Auditor's powers under the constitution, the limits on the ability of the legislature to constrain the Auditor's duties, and the so-called "single subject rule."

The district court and the Minnesota Court of Appeals<sup>2</sup> upheld the 2015 change in law.

On April 18, 2018, the Minnesota Supreme Court affirmed the Court of Appeals decision, ruling that the 2015 law does not unconstitutionally alter the State Auditor's powers and does not violate the single subject rule.<sup>3</sup>

## **Summary and Current Status**

Minnesota counties are required to have an annual audit. Before 2016, the State Auditor chose whether to conduct an annual financial audit of a county or to hire a CPA to perform a financial audit for a county. In 2015, the legislature enacted a change, effective in 2016, to the county audit statute to allow counties to choose to have their audits conducted by a private CPA firm. The State Auditor brought a lawsuit<sup>4</sup> in 2016 against three counties that exercised this option, asserting that the 2015 law was an unconstitutional violation of the separation of powers as well as a violation of the so-called "single subject rule."

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<sup>1</sup> Laws of Minnesota 2015, chapter 77, art. 2, sec. 3 (codified at Minnesota Statutes 2016, section 6.481); and Laws of Minnesota 2015, chapter 77, art. 2, sec. 88 (repealed Minnesota Statutes 2015, section 6.48).

<sup>2</sup> Otto v. Wright County, 899 N.W.2d 186 (Minn. Ct of App. 2017).

<sup>3</sup> Otto v Wright County, 910 N.W.2d 446 (Minn. 2018).

<sup>4</sup> Otto v. Wright County, Becker County, and Ramsey County, Minnesota District Court, Second Judicial District, Court File No. 62-CV-16-606.

On September 2, 2016, the district court decided that:

- conducting audits of county financial statements is a “core function” of the State Auditor’s duties;
- the amendment to the state law enacted in 2015 did not take away this core function of the State Auditor, because the new law contained sufficient oversight powers and duties for the State Auditor with regard to county audits; and
- the State Government Omnibus Finance bill of 2015 did not violate the single subject rule.

The State Auditor appealed the holding that the 2015 law did not affect the Auditor’s core functions and did not violate the single subject rule. The counties appealed the holding that the audits are a core function of the State Auditor’s duties.

The Court of Appeals upheld the district court’s decision. The Minnesota Supreme Court affirmed the ruling of the Court of Appeals.

### **History of the Duties of the State Auditor**

From 1858 to 1973, the State Auditor’s duties were to be the state’s chief controller and official bookkeeper.<sup>5</sup> The auditing of local governments was the duty of a statutorily created office, the Office of the Public Examiner, from 1913 until 1973.<sup>6</sup> In 1973, the legislature abolished the Office of the Public Examiner and assigned local government auditing to the State Auditor.<sup>7</sup> Under the county audit statute from 1973 to 2016, the State Auditor decided whether it would conduct county audits itself or allow a county to hire a CPA firm to conduct the audit.<sup>8</sup> In recent years, the State Auditor conducted annual audits of 59 counties and allowed CPA firms to audit 28 counties.<sup>9</sup>

### **In 2015, the Legislature Changed the County Audit Statute to Permit Counties to Hire Private CPAs**

The State Departments Omnibus Budget bill of 2015<sup>10</sup> repealed the county audit statute<sup>11</sup> and replaced it with a new county audit statute<sup>12</sup>. The effect of this change was to permit counties to choose to hire a CPA firm rather than pay the State Auditor for audits. The amended statute still provides oversight duties for the State Auditor, such as:

The state auditor may require additional information from the CPA firm if the state auditor determines that is in the public interest, but the state auditor must accept the audit unless the state auditor determines it does not meet recognized industry auditing

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<sup>5</sup> “County Audits – Special Review,” Office of the Legislative Auditor, February 3, 2016, p. 15.

<sup>6</sup> Id.

<sup>7</sup> Id.

<sup>8</sup> Id., p. 1.

<sup>9</sup> Id., p. 1.

<sup>10</sup> Laws of Minnesota 2015, chapter 77.

<sup>11</sup> Minnesota Statutes 2015, section 6.48.

<sup>12</sup> Minnesota Statutes 2016, section 6.481.

standards or is not in the form required by the state auditor. The state auditor may make additional examinations as the auditor determines to be in the public interest.<sup>13</sup>

### **Most Counties Chose to Hire CPA Firms to Conduct Their Audits**

In the past, the State Auditor had, as a matter of practice, contracted with counties on a three-year basis to perform their audits at specified rates.<sup>14</sup> When that cycle ended in December 31, 2014, the Auditor sent a letter to each county stating either that the State Auditor would conduct that county's audit or that the Auditor would require the county to retain a private CPA firm.<sup>15</sup> For 61 counties, the State Auditor also included a three-year contract for the State Auditor's services.<sup>16</sup> Fifty counties, including Wright, Becker, and Ramsey, refused to sign the three-year contract.<sup>17</sup> Wright and Becker counties declined to commit to use the State Auditor's services in the future; Ramsey County expressed a preference for a year-to-year arrangement.<sup>18</sup>

### **The State Auditor Sued Counties that Chose Private CPAs; the District Court Decided that the Counties May Hire Private CPAs**

On August 1, 2016, the State Auditor filed a lawsuit against Wright, Becker, and Ramsey Counties. The State Auditor argued that because the State Auditor is a constitutional officer of the state, it is unconstitutional for the legislature to remove or reduce the State Auditor's duties with regard to conducting county audits. The State Auditor asked the court to declare the following:

- 1.) that the statute requires the counties to submit to the constitutional authority of the State Auditor or, in other words, a declaration that counties may not opt out of audits performed by the State Auditor and must submit to those audits for an entire three-year audit cycle;
- 2.) that the statute violates the separation of powers clause of the state constitution by limiting the Auditor's authority relating to auditing counties and by transferring an inherent core function of the Auditor to county governments; and
- 3.) that the State Government Omnibus Finance bill that contained the change to the auditor's statute violated the "single subject rule" of Article IV, section 17 of the state constitution, and therefore the county audit statute change must be severed from the bill and declared null and void.

The State Auditor's argument invoked the separation of powers doctrine. The courts have interpreted the separation of powers doctrine to preclude the legislature from transferring "core functions" away from a constitutional office. Still, courts have held that the legislature is permitted to modify the duties of a constitutional office "as the public health and welfare

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<sup>13</sup> Minnesota Statutes 2016, section 6.481, subd. 3.

<sup>14</sup> "Order Granting in Part and Denying in Part Plaintiff's Motion for Summary Judgment," Minnesota District Court, Second Judicial District, Court File No. 62-CV-16-606, September 12, 2016, p. 4.

<sup>15</sup> Id., p. 4

<sup>16</sup> Id., p. 4.

<sup>17</sup> Id., p. 5.

<sup>18</sup> Id. p. 5.

demand.”<sup>19</sup> Therefore, to determine whether the 2015 change to the county audit statute was a permissible use of authority, the district court in the present case evaluated whether the change to the State Auditor’s core duties was drastic. The court noted that the new county audit statute does not eliminate the State Auditor’s ability to perform audits and specifies duties for the State Auditor in setting standards for and evaluating the compliance of audits from CPA firms.

The district court decided as follows:

- 1.) The district court evaluated the history of the State Auditor’s functions and concluded that monitoring the financial audits of counties is a core function of the State Auditor.<sup>20</sup>
- 2.) The district court considered the duties for the State Auditor in the new county audit statute, and concluded that the State Auditor continues to have the authority to audit counties – by performing audits or reviewing outside audits for compliance – and therefore the State Auditor’s duties were not transferred away from the office to such a degree that the office was rendered a hollow shell. Therefore, the change to the new county audit statute did not disturb the inherent authority of the State Auditor under the constitution.
- 3.) Finally, the court held that the section in the 2015 State Departments Omnibus Budget bill that permitted counties to hire CPA firms “is related to the operation of state government by more than a mere filament” to the other provisions in that bill. Therefore, the single-subject rule was not violated.

The result of this holding is that the 2015 law remains in effect and counties may hire private CPAs to conduct their annual financial audits.

### **Court of Appeals Decision**

On October 12, 2016, the State Auditor appealed the ruling on the second and third issues to the Minnesota Court of Appeals. On October 14 and October 19, the counties appealed the decision on the first issue. On May 30, 2017, the Court of Appeals upheld all three of the district court’s holdings: 1) auditing counties is a core function of the State Auditor; 2) the 2015 law did not violate the separation of powers and was a permitted modification by the legislature of the State Auditor’s duties; and 3) the State Auditor provision in the 2015 State Departments Omnibus Budget bill did not violate the single subject rule.

### **Supreme Court Decision**

On April 18, 2018, the Minnesota Supreme Court affirmed the decision of the court of appeals.<sup>21</sup> The Supreme Court held as follows: 1) that the 2015 change to the State Auditor’s duties permitted the Auditor to retain significant duties and responsibilities in connection with audits of counties and therefore was not a violation of the separation of powers clause; and 2) the

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<sup>19</sup> *State ex rel. Mattson v. Kiedrowski*, 391 N.W.2d 777, 780-781.

<sup>20</sup> *Otto v. Wright County, Becker County, and Ramsey County*, Minnesota District Court, Second Judicial District, Court File No. 62-CV-16-606, “Order Granting in Part and Denying in Part Plaintiff’s Motion for Summary Judgment,” September 12, 2016, p. 9.

<sup>21</sup> *Otto v. Wright County, Becker County, and Ramsey County*, 910 N.W.2d. 446 (Minn. 2018)

provisions regarding the state auditor in the 2015 State Departments Omnibus Budget bill were germane to the operation of state government and therefore did not violate the single subject law. The Supreme Court did not comment on whether the auditing of counties was a “core function” of the office of the State Auditor. Rather, the Supreme Court concludes that “even assuming ...it is a core function,” the change does not result in an impermissible gutting of the office because the 2015 law leaves with the State Auditor “substantial and substantive responsibilities” in connection with county audits.<sup>22</sup>

The Supreme Court’s analysis of the single subject rule emphasizes that the test to be applied is “germaneness.” The Court determined that the State Auditor provisions were germane to the subject “the operation of state government,” a phrase from the title of the bill.

The opinion includes one sentence that might be regarded as a cautionary note: “[w]e reach this conclusion even though other provisions in the bill may not be germane to the subject ‘the operation of state government.’”<sup>23</sup>

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<sup>22</sup> Otto v. Wright County, Becker County and Ramsey County, 910 N.W.3d at 452-455.

<sup>23</sup> Id. at 458.