

## Senate and Assembly Select Committees on Improving State Government

### *Improving California's Budgeting and Oversight: Budget Process Reforms, Oversight of State Government Agencies & Departments*

December 8, 2009

#### Introduction

In my testimony today, I will discuss how my office can assist the Legislature as it enhances its oversight role. I will provide a brief historical perspective on how my office has been used as a resource for legislative oversight including the budget subcommittee process, an overview of the types of audits we conduct, and the reports my office publishes and distributes. In addition, I will describe how the Legislature can use these existing reports and our services to improve transparency and accountability. Finally, I plan to present a new concept that would promote advance planning to further integrate the audit process into the budget subcommittee process while also institutionalizing legislative oversight.

The California State Auditor's Office is the independent and nonpartisan audit, evaluation, and investigative arm of the Legislature. As such, oversight and accountability are at the core of the services my office provides to the Legislature, the Governor, and the citizens of California. Effective legislative oversight is increasingly important and challenging as government continues to grow and become more complex. Adding to this challenge, the tight fiscal constraints of recent years makes legislative oversight and its focus on the effective and efficient use of public resources even more critical. Furthermore, in this era of term limits, the institutional knowledge that resides within my office on the complexities of government operations can and should be used to assist the Legislature in conducting effective oversight. My office currently has a variety of resources available that can assist the Legislature as it strengthens its role in providing transparency and improving the efficiency of state government.

Historically, the State Auditor's Office was more involved than it is today in legislative oversight. For example, in past years the State Auditor participated in budget subcommittee hearings to assist the Legislature in holding state agencies accountable for improving their operations and their ability to serve the public. State agencies that were the subject of a recent audit were often required to report their progress in taking corrective action to respond to our audit findings and recommendations. In many cases, a representative from my office was invited to attend these budget subcommittee hearings to provide an independent perspective on the agency or department's progress. This approach proved effective and strongly encouraged state agencies to take corrective action that frequently had fiscal or operational benefits. In the past, my office also testified more often at policy committee hearings along with state agencies. Reinstating

this practice will provide more transparency and accountability during the budget and policy committee processes and will strengthen legislative oversight. Reinstating these past practices is something that can be done now.

Following is an overview of the resources my office has available that the Legislature can begin using to improve the accountability and transparency of government operations.

**Types of Audits (Performance, Financial, and Compliance):** My office conducts performance, financial, and compliance audits that are either mandated by statute or requested by any member of the Legislature and approved by the Joint Legislative Audit Committee (JLAC).

- Performance audits provide information to improve operations and facilitate decision making by parties with responsibility to oversee or initiate corrective action and improve accountability. These audits can cover a wide variety of objectives, including objectives related to providing perspective, analysis, guidance, or summary information. Performance audits also assess program effectiveness and results, as well as economy and efficiency.
- Generally, financial audits provide reasonable assurance about whether the financial statements of an organization, project, or entity are presented fairly in all material respects in accordance with Generally Accepted Accounting Principles. These audits also assess whether the organization, project, or entity has complied with laws and regulations for those transactions and events that may have a material effect on the financial statements.
- Compliance audits relate to assessments of compliance with criteria established by laws, regulations, contractual provisions, leases, and grant agreements.

**The Single Audit:** California statutes mandate that the State Auditor annually conduct the statewide Single Audit, which includes a combination of the State's independent financial statement audit and the independent audit of numerous federal programs administered by state agencies in California. Federal law conditions California's receipt of billions in federal funds—including those authorized under the American Recovery and Reinvestment Act (ARRA)—on this annual audit performed by my office. Congress created the Single Audit Act of 1984 to improve auditing and management of federal funds it provides to state and local governments. The Single Audit is the primary tool the federal government uses for oversight and accountability of federal funds, particularly ARRA funds.

**The High Risk Audit Program:** State law authorizes the State Auditor's Office to develop a risk assessment process for the State and establish an audit program for identifying state agencies that are at risk for potential waste, fraud, abuse, and mismanagement or that have major challenges associated with their economy, efficiency, or effectiveness. High-risk programs and functions include not only those particularly vulnerable to fraud, waste, abuse, and mismanagement but also those of particular interest to the citizens of the State and those that have potentially significant effects on public health, safety, and economic well-being. The law also authorizes my office to audit any state agency that we have identified as being at high risk and to publish related reports at least once every two years.

Our recent biennial report published in June 2009, identified three new issues that we have added to the high-risk list: (1) the State's budget condition, (2) the State's administration of the \$85.4 billion the State expects to receive under ARRA, and (3) the production and delivery of electricity. In addition, this report provides updates on the issues and areas we included in our inaugural report published in May 2007: maintaining and improving infrastructure, management of human resources, post-employment benefits of retiring employees, emergency preparedness, and information technology government. Finally, our report concludes that three state agencies continue to face challenges in their day-to-day operations: the California Department of Corrections and Rehabilitation, the Department of Health Care Services, and the California Department of Public Health.

**Audit Follow-Up Process:** To hold state agencies accountable for taking corrective action in response to audit findings and recommendations, my office has in place a strong audit follow-up process. Specifically, state law (the Audit Accountability Act) requires state agencies audited by my office to provide written updates on their status in implementing audit recommendations at intervals prescribed by the State Auditor. In keeping with our long-standing practice, after we publish an audit report, the auditee must report to my office at three intervals—60 days, six months, and one year—the action, if any, taken to address the audit findings and recommendations. This correspondence is public information, available to the Legislature to use, for example, during the budget subcommittee process or policy committee hearings. In addition, we summarize these responses in our annual subcommittee reports to the Legislature, one of several special reports we publish each year. Furthermore, when an auditee fails to take or complete corrective action after one year, my office identifies these findings and recommendations and notifies the respective agency and again requests the agency to provide a written update on their status in implementing the audit recommendations. Finally, in January each year we publish a report that summarizes these recommendations and the respective agency's written responses.

## **Special Reports to the Legislature**

**Annual Summary of the Status of Implementation of State Auditor Recommendations (Subcommittee reports):** This annual report summarizes the major findings and recommendations for audit and investigative reports we issued in the previous two calendar years. The report identifies the actions, if any, the auditees reportedly have taken in response to audit findings and recommendations. We organize this report by policy areas that generally correspond to the Senate and Assembly standing committees. In addition, this special report includes an appendix that summarizes monetary benefits auditees could realize if they implement our recommendations or take appropriate corrective action. My office distributes this report to every member of the Legislature and to the relevant policy committees. Finally, we present this information in separate reports specifically tailored to each Senate and Assembly budget subcommittee.

**Audit Accountability:** California statutes enacted in 2007 require my office to report on state agency audit recommendations that are over a year old and have not been implemented. This report is a high-level summary of the scope of each respective audit along with those recommendations we determined to be outstanding at one year after the public release of the

audit report. Each recommendation is followed by the agency's response on the current status of implementing the recommendation. We provide an easy to use table that summarizes the information contained in the report in order to facilitate your use of information. We publish this report by January 15 each year and distribute it to JLAC, the Department of Finance, the Joint Legislative Budget Committee, and the relevant policy committees.

**Legislative Recommendations:** While most of our recommendations are directed to the auditee, we also make recommendations for the Legislature to consider in striving for efficient and effective government operations. This annual report summarizes those outstanding recommendations we made in the two years prior to its publication for the Legislature to consider or recommendations for the auditee to seek legislative changes. In addition, we include a list of legislation chaptered or vetoed in the previous legislative session that was based, in part, on recommendations from our audit reports. We distribute this report to every member of the Legislature and to the relevant committees.

**Data Reliability:** This report summarizes the results of assessments of the reliability of data maintained by state agencies in a wide variety of databases and automated spreadsheets. The purpose of this report is to compile the results of those assessments to call attention both to areas of concern, where important data maintained by state agencies is not accurate or complete, as well as instances when the information has been reliable. We published our inaugural report in October 2008 and intend to issue another report in 2010.

### **Using the State Auditor's Existing Products and Services**

I believe the Legislature can use these existing products and services to improve the transparency and accountability of government operations. But first we must make sure every member of the Legislature is aware and regularly informed on the role my office plays in legislative oversight including the types of audits we conduct, our strong audit follow-up process, and how the Legislature can use my office during budget and policy committee deliberations.

The oversight work my office is conducting on the ARRA funds awarded to California is a good example of how the Legislature as well as the federal government is enhancing oversight using the resources and expertise in my office. The annual statewide Single Audit my office conducts is the primary tool the federal government relies on to ensure proper oversight of federal funds, including ARRA dollars. Recognizing the enormity of federal funds appropriated for distribution to state and local governments, ARRA calls for rigorous and continuous oversight of the expenditure of those funds. In March 2009, shortly after the President signed the landmark legislation I made a presentation to the Assembly Accountability and Administrative Review Committee explaining the scope and purpose of the Single Audit and the important role my office plays in the oversight of federal programs, including those funded with ARRA dollars. Tomorrow morning, I am scheduled to update the committee on the audit work my office has completed since the previous hearing.

Furthermore, in May 2009, I provided testimony to JLAC on ARRA oversight, accountability, and the risks associated with the large influx of federal funds California is expected to receive. Subsequently, the chair and several other members of JLAC requested an audit that the committee

approved directing my office to conduct preparedness reviews and early testing on five federal programs expected to receive a significant amount of ARRA funding. As we complete this audit work—portions of the Single Audit and additional assessments I initiated under my high-risk authority—my office is publishing interim reports for management and those charged with governance to address the deficiencies we identify.

This nontraditional approach of providing interim communication of audit results has proven very effective because it provides information necessary for management and the administration to address deficiencies and correct problems they may not otherwise have known about until after large amounts of federal dollars flow into the State. This interim communication also ensures transparency and informs the Legislature and the public about the use of federal funds. Furthermore, these interim reports serve as yet another resource for the Legislature to use in enhancing its oversight role to ensure the proper administration of federal programs and the efficient and effective use of federal dollars to avoid jeopardizing their loss or misuse.

I strongly encourage the Legislature to further integrate the results of our other audit work and our special reports into the budget subcommittee process and when relevant into the policy committee hearings. My office is available and eager to assist the Legislature in this manner.

### **The Audit Plan**

In addition to using our existing products and services, I believe the Legislature can utilize my office in new ways to provide more effective oversight. One suggestion I discussed with various legislative members earlier this year is the concept of developing a one or two-year audit plan. My office would develop this plan based on input from the budget subcommittees and JLAC. In concept, the audit plan would identify state agencies, programs, or issues the budget subcommittees would like my office to examine and report on during the budget process. Each year, JLAC would approve the audit plan and direct my office to complete all or portions of the plan and report the results of our audit work to the budget subcommittees and JLAC. Such a process would promote advance planning for fiscal oversight. Moreover, it would further integrate legislative oversight as part of the budget process with the desired outcome of improving accountability and creating an efficient and effective government for all Californians. Finally, it would institutionalize legislative oversight in this era of term limits. If this is a concept the Legislature would like to examine further, my office welcomes the opportunity to work out the details to implement such a plan.

In closing, my office is prepared to assist the Legislature in its desire and effort to improve legislative oversight. With proper planning and coordination, I believe we can make incremental progress immediately. I intend to work with the chair of JLAC and the budget committees to further my idea and suggestion to implement an audit plan. I welcome the opportunity to work with members of these committees and your staff as well as others in the Legislature to accomplish our common goal of improving government through effective legislative oversight.