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Hearing of the Accountability and Administrative Review Committee

California State Auditor Testimony for Federal Stimulus Transparency March 25, 2009

BACKGROUND

The California State Auditor is the independent and nonpartisan audit, evaluation, and investigative arm of the Legislature and the citizens of California. In addition to conducting performance audits as requested and approved by the Joint Legislative Audit Committee or mandated in statute, my office is responsible for annually conducting California's statewide Single Audit—a combination of the independent financial statement audit and the independent audit of numerous federal programs administered in California. Federal law conditions the State's receipt of federal funds on this annual audit performed by an independent auditor.

Single Audit

Congress created the Single Audit Act of 1984 to improve auditing and management of federal funds provided to state and local governments. The act requires a single organization-wide financial and compliance audit for state and local governments. The act is intended to promote sound financial management, including effective internal controls, with respect to federal awards administered by state and local governments and nonprofits. Internal controls encompass a system of accounting and administrative controls, including a system of authorization and record-keeping procedures adequate to provide effective control over assets, liabilities, revenues, and spending. State law requires each state agency to establish and maintain a system of internal accounting and administrative controls.

In addition to internal controls, the act focuses on the recipient's compliance with laws and regulations governing federal awards. Compliance refers to how well the respective agency receiving federal funds complies with the requirements in federal law, regulations, contracts, and grants applicable to each of the federal programs.

As required by the Single Audit Act, my office complies with Generally Accepted Government Audit Standards when conducting the financial and federal compliance audit. The United States Comptroller General/Government Accountability Office issues these standards. In addition, the U.S. Office of Management and Budget (OMB) issues guidance for auditors to follow when conducting the Single Audit. This guidance is intended to provide for consistency and uniformity for the audit of States', local governments', and nonprofit organizations' expenditure of federal awards. The guidance identifies 14 compliance requirements listed below that our teams audit when they have a direct and material effect on major programs.

	Compliance Requirement	Brief Description of Requirement
1.	Activities Allowed or Unallowed	Specifies the activities that can or cannot be funded under a specific program.
2.	Allowable Costs/Cost Principles	Describes selected cost items, allowable and unallowable costs, and standard methodologies for calculating indirect costs rates.
3.	Cash Management	Establishes how recipients of federal funds must follow procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury to disbursement.
4.	Davis-Bacon Act	With regards to construction contracts, specifies requirements for wages of laborers and mechanics employed by contractors or subcontractors, when required by the Davis-Bacon Act.
5.	Eligibility	Specifies criteria for determining the individuals, groups of individuals, or subrecipients that can participate in the program and the amounts for which they qualify.
6.	Equipment and Real Property Management	Provides requirements for purchasing, using, managing and disposing of equipment and real property.
7.	Matching, Level of Effort, Earmarking	Specifies requirements to provide contributions of a specified amount or percentage to match federal awards, a specified level of service and expenditures for specified activities, and the minimum and/or maximum amount or percentage of the program's funding that must/may be used for specified activities.
8.	Period of Availability of Federal Funds	Provides the time period during which federal funds may be used.
9.	Procurement and Suspension and Debarment	Stipulates how to procure goods or services and prohibits contracting or making subawards to parties that are suspended or debarred.
10.	Program Income	Provides requirements related to gross income—income that is directly generated by the federally funded project during the grant period. Generally program income is deducted from program outlays.
11.	Real Property Acquisition and Relocation Assistance	Governs how property is acquired to ensure uniform and equitable treatment of persons displaced from their homes, businesses, or farms by federally assisted programs.
12.	Reporting	Specifies the nature, form, and timing of financial reports.
13.	Subrecipient Monitoring	Identifies responsibilities for pass-through entities (those that provide funds to subrecipients and others) with regards to awarding, monitoring, and auditing federal funds.
14.	Special Tests and Provisions	Specific requirements, which are unique to each federal program that are found in the laws, regulations, and the provisions of contracts or grant agreements pertaining to the program.

Audit of Federal Programs

The number and type of federal programs audited each year as part of the Single Audit is formula driven as stipulated by the federal OMB. Last year my office audited 43 programs, which represented 78 percent of the \$76 billion in federal funds the state received. The OMB requires certain programs to be audited every year (Type A) and others to be audited on a cyclical basis (Type B).

Below are the results of the prior-year audit, *State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2007*, issued in June 2008:

Federal dollars received by California as of June 30, 2007	\$ 76 billion
Federal receipts audited by the California State Auditor	\$ 59 billion

Total Programs Audited

Type A programs 23 programs	(more than \$73.6 million in federal receipts)
Type B programs 20 programs	(more than \$14.7 million but less than \$73.6 million in federal receipts)

AMERICAN RECOVERY AND REINVESTMENT ACT (FEDERAL STIMULUS)

The American Recovery and Reinvestment Act (Recovery Act) is intended to create and save jobs, jump-start our economy, and build the foundation for long-term economic growth. The Recovery Act includes measures to modernize the nation's infrastructure, enhance America's energy independence, expand educational opportunities, increase access to health care, provide tax relief, and protect those in greatest need. Recognizing the enormity of federal funds appropriated for distribution to state and local governments by the Recovery Act, it calls for rigorous and continuous oversight of the distribution and expenditure of those funds.

Funding for Oversight

Although the Recovery Act appropriates federal funds to the U.S. Government Accountability Office (GAO), federal Inspectors General offices, and the Accountability and Transparency Board (Board) for their oversight responsibilities, it does not specifically appropriate funds for the additional oversight responsibilities placed on the states as a result of the Recovery Act. The Recovery Act provides the following funds at the federal level:

Recovery Accountability and Transparency Board	\$84 million
Government Accountability Office	\$25 million
Federal Inspectors General	\$221.5 million

Recovery Accountability and Transparency Board

The Recovery Act creates the Board to coordinate and conduct oversight of funds distributed in order to prevent fraud, waste, and abuse. The Board is composed of a chair, Earl Devaney, who was appointed by the President and 10 Inspectors General specified in the Recovery Act. The Recovery Act requires the Board to issue quarterly and annual reports on the use of Recovery

Act funds and any oversight matters. The Recovery Act specifically directs the Board to coordinate its oversight activities with the GAO and state auditors.

The Board may make recommendations to agencies on measures to avoid problems and prevent fraud, waste, and abuse. Finally, the Board is charged with establishing and maintaining a user friendly Web site—www.recovery.gov—to foster greater accountability and transparency in the use of federal stimulus funds.

Government Accountability Office

The GAO, the federal equivalent of the Bureau of State Audits, is an independent, nonpartisan agency that works for Congress. Led by the Comptroller General, the GAO investigates how the federal government spends taxpayer dollars. In addition, the GAO's mission is to support the Congress in meeting its constitutional responsibilities and to improve the performance and ensure the accountability of the federal government for the benefit of the American people.

The Recovery Act places several new oversight responsibilities on the GAO, including the following:

- Reporting bimonthly regarding the use of Recovery Act funds by selected states and localities—the GAO has selected California as one of those states. The first report is scheduled to be issued on April 17, 2009.
- Posting the reports, along with any audits conducted by the GAO of federal funds, on the Internet and the Web site established by the Board.

The GAO has already initiated coordination with state auditors and has met with my office regarding its review and audit activities. The GAO is looking to my office—as California's expert on the independent audit of federal funds—for guidance and will likely rely heavily on the federal single audit work we conducted. Additionally, my office has already participated in several discussions with the federal accountability community and will continue to do so. We are also providing feedback to OMB regarding the guidance it is providing to states regarding the states' oversight of funds received under the Recovery Act.

Federal Inspectors General

To ensure efficiency and effectiveness within government, then-President Carter signed into law the Inspector General Act (IG Act). The IG Act and its subsequent amendments created independent Offices of Inspector General for all federal agencies. The federal inspectors general act as watchdogs of their respective federal agencies by promoting economy and efficiency, while also detecting fraud, waste, and abuse in the agency's programs. Inspectors general work with agency heads by keeping them informed of, and suggesting ways of improving, problems or deficiencies in their programs.

Inspectors general are required to independently report monthly on all obligations for Recovery oversight activities at their respective agencies for both Recovery Act funds and non-Recovery Act funds. Monthly reports must be submitted no later than five working days after the last day of the reporting month.

The duties of the inspector generals include, among other things:

- Reviewing concerns raised by the public about specific investments funded with Recovery Act funds and posting the findings of these reviews on their respective Web sites.
- Investigating matters referred by the Board regarding wasteful spending, poor contract or grant management, or other abuses.
- Investigating alleged reprisals against whistleblowers employed by state and local governments and contractors that receive Recovery Act funds.

THE ROLE OF THE CALIFORNIA STATE AUDITOR

Although many questions need to be answered and more guidance is forthcoming, it is clear that the influx of an estimated \$31 billion of federal Recovery Act funds will create additional oversight and accountability responsibilities for state auditors including the California State Auditor's Office.

Federal Single Audit Act

In addition to our oversight role in coordination with the GAO and the Board, based on our initial analysis of the portion of estimated stimulus funds that California will receive and the formula for determining which programs require an audit, it is likely that my office will need to conduct eight additional audits of Type A programs. Further, we estimate the addition of six new Type B programs. Moreover, draft guidance provided by OMB indicates that other programs can be deemed high-risk (and therefore are to be considered "Type A" programs) if the federal agency determines it is necessary, in which case, my office would be required to conduct an audit of those programs.

Additionally, we anticipate that 14 programs, which we currently audit as Type A, will receive additional funds under the Recovery Act, potentially increasing the audit effort needed and the cost to audit those programs. Finally, OMB guidance indicates that the Recovery Act may establish new requirements under existing programs, which would also increase our audit responsibilities.

Finally, the federal Single Audit typically looks backwards, auditing funds that have already been expended by the programs we audit. However, the Recovery Act calls for "real time" auditing and oversight as the funds are being distributed and expended.

Whistleblower Protection

While the Recovery Act affords whistleblower protection to state and local employees who report incidences of waste, fraud, and abuse relating to Recovery Act funds, this protection is intended to be in addition to any existing state whistleblower protection laws. My office is responsible for administering the California Whistleblower Protection Act, which includes authority to investigate improper governmental activities by state employees, including, among

other things, gross mismanagement and abuse of federal funds. State law requires state agencies to annually notify state employees about their rights as a whistleblower. As a means of strengthening oversight, we intend to make state employees aware of their rights to make complaints about the misuse of Recovery Act funds to our Investigations Unit.

Transparency and Accountability

Transparency and Accountability are at the core of the services my office provides to the Legislature, the Governor, and the citizens of California. We are considering a variety of means to provide California's leaders and citizens, as well as the federal government, with timely information on our oversight of the expenditure of Recovery Act funds. To that end, we are currently in the process of developing a webpage specifically devoted to California's accountability under the Recovery Act.