

Uniform Replacement Allowances Increased

Chapter 364, Statutes of 1977, authorized the Board of Control to increase the uniform replacement allowances for state employees whose replacement costs exceed \$150. No provision has been made in departmental budgets for funding the increased allowances. These items provide a total of \$1.2 million, to be allocated by the Department of Finance based on actual expenses incurred in the budget year.

Price Trends Generally Steady

We recommend reduction of \$1.5 million requested to fund price increases not anticipated in departmental budgets.

Each year the Department of Finance issues price adjustment guidelines for use by all departments in preparing their budgets. These guidelines include expected percentage increases for selected items such as food, travel, utilities and fuel, as well as a general factor for all other operating expenses and equipment. The price increase for this general factor in departmental budgets is 6 percent for 1978-79. Based on the consensus of current economic forecasts, it appears that departmental budgets have been adequately adjusted to compensate for anticipated price increases in the budget year. Therefore, the additional \$1.5 million provided by Item 427 to fund price increases is unnecessary.

FEDERAL REVENUE SHARING AUDITS

Item 430 from the General Fund

Budget p. 1112

Requested 1978-79	\$3,500,000
Estimated 1977-78.....	None
Total recommended reduction	Pending

SUMMARY OF MAJOR ISSUES AND RECOMMENDATIONS

Analysis page

1. Revenue Sharing Audits. Withhold recommendation pending receipt of supporting justification and budget detail. 1101

ANALYSIS AND RECOMMENDATIONS

The "State and Local Assistance Act of 1972," (General Revenue Sharing), provides federal funds to units of state and local government. The funds are allocated on the basis of local tax effort and population. This act was extended and amended on October 13, 1976 by the "State and Local Assistance Amendments of 1976," (HR 13367). The amendments to the act significantly altered the law in regard to auditing requirements. The original act placed the responsibility for auditing these funds with the Director of the Office of Revenue Sharing in the U.S. Treasury Department. The amendments to the act (Section 123) place the responsibility for auditing on the recipient government and define the frequency of audit that is required.

FEDERAL REVENUE SHARING AUDITS—Continued

Specifically, the law requires each recipient government to have an independent audit of its financial statements in accordance with generally accepted auditing standards, not less often than once every three years. The Department of the Treasury, Office of Revenue Sharing has issued regulations which more specifically define the audit requirements. These regulations (Section 51.101) require that the audit be of the financial and compliance type and specifically define what constitutes an independent audit.

The Fiscal Management Audits (FMA) unit of the Department of Finance currently audits state funds and agencies on a two to four year cycle. However, the Office of Revenue Sharing has not yet recognized FMA as an independent audit entity.

Independent auditors for state accounts are defined by the new regulations as either:

1. State auditors when:

- (a) elected by the citizens of the state; or
- (b) elected or appointed by and reporting to the state Legislature or a committee thereof; or
- (c) appointed by the Governor and confirmed by and reporting to the state Legislature.

2. Independent public accountants when:

- (a) certified public accountants; or
- (b) public accountants licensed on or before December 31, 1970 by a regulatory state authority.

Potential Auditability Problems

The Treasury regulations (Section 51.102) allow a waiver of the auditing requirements by the Director of the Office of Revenue Sharing if the recipient government's accounts are not auditable. The waiver must be applied for by March 31, 1978, by the Governor on the basis of an independent auditor's opinion that the financial accounts are not auditable. The waiver application must also include a report on arrangements that have been made or steps taken toward making the financial accounts auditable. If an application for waiver is not filed, and subsequently an independent auditor renders an opinion that financial accounts of the State of California are not auditable, California's Revenue Sharing allocation could be in jeopardy.

The auditability of California's funds is unclear at this time. The General Revenue Sharing Law and regulations provide no guidance or criteria to determine auditability.

Generally, financial statements would be unauditable only where the auditor did not have access to records because they were not prepared, missing, destroyed or confidential. Problems also exist where *some* (but not all) records were not prepared or are missing, where funds are intermingled without separate supporting records, and where access is restricted by law or regulation.

Information provided by FMA indicates that some records are not being prepared by agencies and access restrictions would present problems for

auditing the Franchise Tax Board, Board of Equalization, State Controller, Department of Benefit Payments, Department of Justice, and Department of Health. Information on the auditability of the State Legislature was not available.

Attorney General's Opinion Pending

Federal regulations allow the State Attorney General to make a determination on which funds need to be audited for revenue sharing. Opinions on this determination were requested on September 15 and October 31, 1977 by the Director of Finance. Responses were not prepared in time for review in this analysis.

Contracting Procedure Problems

There are several alternative ways for contracting CPA services (e.g., bids, requests for proposals, prequalification to bid, single source contracts or some combination of such procedures). Each procedure has advantages and disadvantages and cost variances are substantial. We believe the proposed contracting procedures should be identified for legislative review.

Audit Opinion Problems

Audit results (technically known as opinions) may be unqualified, qualified, adverse, or in the form of a disclaimer of an opinion (provided the accounts are auditable). The expression of an unqualified opinion under Revenue Sharing audit guidelines requires the inclusion of a statement that the financial statements are in accordance with generally accepted accounting principles. Generally accepted accounting principles are defined as those pronouncements of the National Committee on Governmental Accounting as set forth in its publication, "Governmental Accounting, Auditing and Financial Reporting" (GAAFR). California's accounting system does not conform to the GAAFR requirements in a number of areas.

Need for Budget Detail

We withhold recommendation pending the receipt of additional supporting justification and budget detail.

The \$3.5 million General Fund appropriation proposed in this item is based on the department's estimate of funds required to contract with CPA's to perform the required three-year audits on a phased basis (i.e., one-third of all state agencies annually).

It should be noted that the \$275 million federal revenue sharing money received by the state (the subject of this auditing requirement), is appropriated under Item 409 for payment back to the federal government as a portion of the state's share of the State Supplementary Payment program for aged, blind and disabled persons. That is, no state agency actually receives or uses any of this money. However, as a condition of receipt, all state agencies must be independently audited according to this budget proposal.

We cannot understand a federal policy that would not allow the state's traditional accounting and auditing program to satisfy the federal require-

FEDERAL REVENUE SHARING AUDITS—Continued

ments under these circumstances.

We question also whether sufficient numbers of CPA's are available to handle the workload given the increased "independent" revenue sharing audits that will also be required of all local recipient agencies. It should be noted that an additional \$670,000 is budgeted under Item 349 to allow the Department of Finance to contract with CPA's for reimbursable audits of federal funds (other than revenue sharing), received by state agencies.

In addition to questioning the necessity for and feasibility of the federal requirement and this proposal, we have been unable to evaluate the basis upon which the \$3.5 million funding level was calculated. We also believe a cost estimate for having other state agencies (e.g., Auditor General's office) perform these audits should be available for Legislative consideration. Finally, we believe information on responses by other states to this questionable federal requirement should be available for legislative review.

CAPITAL OUTLAY SUMMARY

The Budget Bill includes approximately \$470.3 million from all sources for capital outlay. This is 49 percent more than the appropriation included in the Budget Act of 1977. However, this is the first year the Department of Transportation capital outlay program has been included in the Budget Bill. When the total is adjusted for the department's \$195.4 million the remaining amount represents an 11.2 percent decrease from the current year appropriation. The most significant decreases are 46 percent in education and 38 percent in health and welfare. Table 1 shows how the amounts in the budget are distributed.

Table 1
Summary of 1977-78 Budget Bill Capital Outlay Appropriation

<i>Organizational Unit</i>	<i>General Fund</i>	<i>Special Fund</i>	<i>Bond Funds</i>	<i>Total all Sources</i>
Legislative/Judicial/Executive	\$1,143,102	—	—	\$1,143,102
State and Consumer Services ..	71,431,170	—	—	71,431,170
Business and Transportation	—	\$207,307,974	—	207,307,974
Resources	10,298,903	15,145,426	\$55,959,389	81,403,718
Health and Welfare	35,621,393	—	—	35,621,393
Education	62,000	59,899,200	6,300,000	66,261,200
General Government	2,166,550	5,000,000	—	7,166,550
Total	\$120,723,118	\$287,352,600	\$62,259,389	\$470,335,107

General Fund

Approximately \$120.7 million (25.7 percent) of the total amount proposed for capital outlay is from the General Fund. This is 14.8 percent higher than the General Fund appropriation in the Budget Act of 1977. The major portion is for the Departments of General Services (\$70.5 million), Developmental Services (\$16 million) and Corrections (\$11.3 million). The remainder consists of relatively small amounts for 28 other