

**STATE OF CALIFORNIA
CALIFORNIA STATE AUDITOR'S OFFICE
621 CAPITOL MALL, SUITE 1200
SACRAMENTO, CA 95814**

**TITLE 2, DIVISION 10, CALIFORNIA CODE OF REGULATIONS
ADOPT SECTIONS 61100 TO 61140, INCLUSIVE, REGARDING HIGH RISK LOCAL
GOVERNMENT AGENCY AUDIT PROGRAM**

FINAL STATEMENT OF REASONS

**UPDATE OF INITIAL STATEMENT OF REASONS AND SUMMARY AND REPOSE
TO COMMENTS RECEIVED DURING RULEMAKING-GOVERNMENT CODE
SECTION 11346.9**

Proposed Section 61100 sets forth a general statement regarding the purpose of Government Code section 8546.10¹ and provides a general description of the matters to be made specific by these regulations: the definitions of key terms; the process by which the State Auditor will identify risk, initiate a high risk local government agency audit, conduct an audit, and perform post-audit follow-up measures to ensure that the recommendations made as a result of the audit are implemented and are effective at improving local government. This proposed regulation is necessary to inform the Legislature, local government agencies, and the general public, and it furthers the purposes of section 8546.10.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period.

Proposed Section 61101 names the program which will be administered by the State Auditor pursuant to section 8546.10 and these proposed regulations. The name reflects the statute and is intended to convey the core purpose of the high risk local government agency audit program, which is to evaluate the effectiveness of local government and to improve its performance. This proposed regulation is necessary to inform the Legislature, local government agencies, and the general public and furthers the purposes of section 8546.10.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period.

¹ All subsequent code section references are to the Government Code, unless otherwise indicated.

Proposed Section 61102 defines the term “abuse” in a manner consistent with the generally accepted government auditing standards adopted by the Comptroller General of the United States. This proposed regulation is necessary to provide clarity to the Legislature, local government agencies, and the general public.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period; however, we made nonsubstantive or grammatical changes to improve the clarity of this proposed regulation.

Proposed Section 61103 identifies the Joint Legislative Audit Committee of the Legislature as the “audit committee.” The Joint Legislative Audit Committee is expressly identified in section 8546.10 as the committee that must approve a high risk local government agency audit before it can be conducted by the State Auditor. This proposed regulation is necessary to provide clarity to the Legislature, local government agencies, and the general public.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period.

Proposed Section 61104 defines the term “fraud” in a manner that is consistent with the generally accepted government auditing standards adopted by the Comptroller General of the United States. This proposed regulation is necessary to provide clarity to the Legislature, local government agencies, and the general public.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period; however, we made nonsubstantive or grammatical changes to improve the clarity of this proposed regulation.

Proposed Section 61105 defines the term “high risk” for purposes of section 8546.10. Defining this term is necessary and important because the definition, along with the risk factors specified in section 61121, will inform the Legislature, local government agencies, and the general public of the factors that will be used to determine whether a local government agency will be considered potentially high risk, and, therefore, potentially subject to a high risk local government agency audit. The definition will inform the Legislature and the general public regarding the operation of the high risk local government agency audit program and furthers the purposes of section 8546.10.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period; however, we made nonsubstantive or grammatical changes to improve the clarity of this proposed regulation.

Proposed section 61106 defines the phrase “local government agency.” The definition contained in the proposed regulation furthers the intent of the Legislature as expressed in section 8546.10. The proposed regulation is necessary to clarify the scope of the high risk local government agency audit program and inform the Legislature, local government agencies, and the general public.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period.

Proposed section 61107 establishes and defines the term “risk factors” to describe the specific criteria that will be used by the State Auditor to determine whether a local government agency should be identified as being potentially at high risk or at high risk. The proposed regulation furthers the intent of section 8546.10 and provides clarity to the Legislature, local government agencies, and the general public regarding the operation of the high risk local government agency audit program.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period; however, we made nonsubstantive or grammatical changes to improve the clarity of this proposed regulation.

Proposed section 61108 provides clarity to the other proposed regulations by noting that the California State Auditor, the state official charged with administering section 8546.10 and these regulations, will be known as the “State Auditor.”

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period.

Proposed section 61109 defines “waste” in a manner consistent with the generally accepted government auditing standards adopted by the Comptroller General of the United States. This proposed regulation is necessary to provide clarity to the Legislature, local government agencies, and the general public.

Comments Received During the 45-Day Public Comment Period

Two nonprofit organizations, the California Special Districts Association (CSDA) and the California State Association of Counties (CSAC), requested that the definition of waste reflect a “prudent person” standard. After careful consideration, the State Auditor declines to make this change. Applying a prudent person standard may be reasonable in some circumstances, but, as used in the context of the proposed regulations and the statute these regulations seek to implement, a wasteful action could be one that seemed prudent at the time it was taken, but that nonetheless resulted in mismanagement or inefficiency. The proposed definition is consistent with the intent of section 8546.10 that this audit program evaluate the effectiveness and efficiency of local government, and no change is needed.

[Sections 61110 to 61119, inclusive, are reserved.]

Proposed section 61120 prescribes the process by which the State Auditor would identify a local government agency as potentially being high risk. Identifying a local government agency as potentially being high risk is a prerequisite for the State Auditor to seek approval to undertake high risk local government agency audits under the program. This proposed regulation informs and provides clarification regarding the operation of the program and furthers the purposes of section 8546.10.

Comments Received During the 45-Day Public Comment Period

CSDA urged the State Auditor to revise subdivision (a) of this proposed regulation to give an affected local agency, at least 90 days prior to being identified as potentially high risk, an opportunity to provide its perspective regarding any areas of concern and to require that the State Auditor “meet and confer” with the affected local agency.

After careful consideration, the State Auditor declines to accept these proposed changes. Although the State Auditor will promote effective communication throughout this process and will notify the affected local agency of the determination that she has preliminarily identified the local agency as being high risk, setting a minimum of 90 days for the agency to provide its perspective would unnecessarily protract the process of identifying risk. Further, this timeframe would not meet the needs of all circumstances, particularly where there is a need to act quickly to mitigate risk. Therefore, the State Auditor reserves the right to make a case-by-case determination regarding the amount of time that will be given to a local agency to provide its perspective. As an administrative practice, the State Auditor intends to provide an affected local agency with a reasonable opportunity, based on the circumstances, to provide its perspective, in writing, to the State Auditor, and the State Auditor will make this response available to the audit committee when submitting the audit request required by proposed section 61130.

As to CSDA’s request to include a “meet and confer” requirement whereby the State Auditor would meet and confer with the affected local agency, the State Auditor cannot agree to this

change, as it is inconsistent with the State Auditor's statutory obligation to comply with generally accepted government auditing standards. A meet and confer process conveys the notion that two parties meet and attempt to resolve their differences through mutual agreement. Under the obligations imposed by generally accepted government auditing standards, the State Auditor must independently determine whether a local agency is at high risk and cannot agree to a meet and confer process. Such a change would be inconsistent with the governing statutes. Nonetheless, the State Auditor intends to provide an affected local agency with a full and fair opportunity to share its perspective with the State Auditor throughout this process. Moreover, consistent with applicable auditing standards, the State Auditor will communicate pertinent information with responsible individuals within the affected local agency and will diligently seek reliable evidence upon which to base audit findings and conclusions. These practices are customary with any audit program performed by the State Auditor and this program will be no different. One of the hallmarks of the audit process is open and full communication that leads to accurate and supportable conclusions.

CSAC requested that the State Auditor revise subdivision (a) of the proposed regulation to state that the local agency would have the opportunity to provide its perspective to the State Auditor prior to the time the State Auditor notifies the audit committee of the determination that a local agency is potentially at high risk. Although not explicit on this point, the proposed regulations already allow the local agency to provide its perspective to the State Auditor prior to the time the State Auditor notifies the audit committee. Therefore, no change is needed. Also, as mentioned above, the State Auditor intends to implement this regulation by allowing an affected local agency a reasonable time to provide its perspective, in writing, on identified areas of risk, and intends to share this information with the audit committee when submitting the audit request required by section 61130.

CSDA urged the State Auditor to revise subdivision (c) of this proposed regulation to provide a local agency with an "advanced draft" copy of the audit proposal required under proposed regulation section 61122. CSDA further requested that the proposed regulation be revised to allow the local agency at least 90 days to address areas of concern, and, if after at least 90 days, the agency has failed to satisfactorily address the areas of concern or develop a satisfactory plan to address the areas of concern, the State Auditor would inform the affected local agency that it may notify the audit committee of its determination and provide the local agency with a revised advanced draft copy of the audit proposal required under proposed section 61122. In addition, CSDA requested that the proposed regulation be revised to allow the local agency to then submit to the State Auditor a final response to the audit proposal. Finally, CSDA requested that the State Auditor revise the proposed regulation to specify that no less than 15 days after providing the affected local agency with a revised advanced draft copy of the audit proposal, the State Auditor "may" notify the audit committee of its determination that a local agency is potentially high risk.

After careful consideration, the State Auditor declines to make these changes. These changes would protract the process of identifying high risk agencies and would be inconsistent with the purpose of the statute, which is to efficiently identify risk and take timely corrective action. However, as indicated above, the State Auditor intends to provide affected local agencies with an opportunity to present their written perspective on potential areas of risk to the State Auditor, prior to the submission of an audit request to the audit committee, and the State Auditor intends to submit this information, if provided, to the committee for its consideration.

We made nonsubstantive or grammatical changes to improve the clarity of this proposed regulation.

Proposed section 61121 specifies the risk factors that the State Auditor may use to identify a local government agency as being potentially at high risk, or at high risk, for waste, fraud, abuse or mismanagement or having major challenges associated with its economy, efficiency, or effectiveness. Specifying the risk factors that may be used for this purpose is essential to providing transparency and clarity to local government agencies throughout California so that they will understand what characteristics of their operations are likely to result in being designated as a high-risk local government agency.

Comments Received During the 45-Day Public Comment Period

CSDA provided public comment on this proposed regulation. CSDA urged the State Auditor to revise the proposed regulation to require that the State Auditor take into account “the unique revenue authority and financial powers of each type of local agency.” It further urged the addition of a requirement that the State Auditor take into account for each local agency “the budget size, staff size and size of population served in order to balance the cost of new practices with the potential risks associated with existing practices.”

After careful consideration, the State Auditor declines to accept the proposed changes. The existing proposed regulation already allows the State Auditor to consider “any additional information obtained from a local agency” when determining whether to designate that entity as potentially high risk or high risk. Therefore, the existing language allows for the consideration of these and other factors, and no changes are needed to address CSDA’s concerns.

CSAC also made a similar public comment. For the same reasons set forth immediately above, we decline to make the change.

Proposed section 61122 specifies that, after identifying a local government agency as being potentially at high risk for waste, fraud, abuse, or mismanagement or having major challenges associated with its economy, efficiency, or effectiveness, the State Auditor has the authority to develop an audit proposal.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period.

[Sections 61123 to 61129, inclusive, are reserved.]

Proposed section 61130 specifies that, prior to conducting an audit of a high-risk local government agency, the State Auditor shall obtain approval from the audit committee, and prescribes related matters, including the information that would be required to be included in an audit proposal submitted to the audit committee. The proposed regulation furthers the purposes of section 8546.10 and provides information and clarity to the Legislature, local government agencies, and the general public regarding the process for obtaining approval to perform high risk local government agency audits.

Comments Received During the 45-Day Public Comment Period

We received three comments on this proposed regulation: one from the chair of the audit committee, Assemblymember Mike A. Gipson, and two similar comments from CSDA and CSAC.

Assemblymember Gipson requested that we amend section 61130 to require that the level of detail in a high risk local government agency audit proposal submitted to the audit committee for its approval be consistent with the level of detail currently required of legislatively submitted audit proposals. Mr. Gipson specifically requested that the audit request include a “detailed description of the scope of work to be performed and the estimated cost and timeframe to complete the work.”

The existing wording of section 61130 allows for this and the State Auditor intends to implement this regulation as suggested by Mr. Gipson. Therefore, no change is needed.

CSDA and CSAC urged the State Auditor to revise this proposed regulation to require that the State Auditor include, along with this audit request, the affected local agency’s response to our preliminary determination of risk when we submit a local agency audit request to the committee. After careful consideration, the State Auditor declines to make this change because the existing language already allows for such a practice. Related to that, the State Auditor intends to implement this regulation by submitting the agency’s response to the audit committee when submitting the audit request required by this proposed regulation.

Proposed section 61131 specifies, consistent with generally accepted rules of statutory construction, that a high risk local government agency audit conducted pursuant to section 8546.10 would be performed in accordance with the State Auditor’s general enabling statutes. This proposed regulation would further the intent of section 8546.10 and provide clarity to the

Legislature, local government agencies, and the general public regarding how high risk local government agency audits will be performed.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period.

Proposed section 61132 specifies that, prior to publishing a high risk local government agency audit report, the State Auditor would be required to provide the audited local government agency with five business days to review and respond, in writing, to a confidential draft of the audit report. This proposed regulation informs and provides clarity to the Legislature, local government agencies, and the general public regarding the opportunity afforded to local government agencies to review and respond to audit reports.

Comments Received During the 45-Day Public Comment Period

Both CSDA and CSAC provided comments regarding the provisions of the proposed regulation that allow an affected local agency five business days to review a confidential draft report, requesting that this review period be extended.

After careful consideration, the State Auditor declines to accept the proposed modification. The State Auditor will communicate audit findings with the affected local agency throughout the audit process and will share preliminary audit findings and recommendations with the affected agency prior to the five business-day review period. Thus, by the time the agency receives the confidential draft for the five business-day review, it already will be very familiar with the substance of what will be contained in the final report. Moreover, the State Auditor will make every effort to provide the affected agency sufficient notice prior to the five business-day review period so that it has the opportunity to properly notice a closed session discussion of the draft report, as permitted by law. In light of the ongoing, regular communication that takes place throughout the audit process between the State Auditor and the affected agency, a five business-day review period is sufficient.

We made nonsubstantive or grammatical changes to improve the clarity of this proposed regulation.

[Sections 61133 to 61139, inclusive, are reserved.]

Proposed section 61140 specifies the manner in which a local government agency would be removed from the high risk local government agency audit program. This proposed regulation is necessary to provide clarity and certainty to local government agencies and to inform the Legislature and the general public regarding removal of the designation of being high risk.

Comments Received During the 45-Day Public Comment Period

The California State Auditor did not receive any comments regarding this proposed regulation during the 45-day public comment period; however, we made nonsubstantive or grammatical changes to improve the clarity of this proposed regulation.

LOCAL MANDATE

This proposal does not impose a mandate on local agencies or school districts.

ALTERNATIVES CONSIDERED

The State Auditor has determined that no reasonable alternative considered by the State Auditor or that has otherwise been identified and brought to the attention of the State Auditor would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provisions of law.