

## **Chapter 3. High Risk Local Government Agency Audit Program**

### **Subchapter 1. General Provisions and Definitions**

#### **§ 61100. Purpose**

These regulations interpret, implement, and make specific the authority of the State Auditor to identify high-risk local government agencies, perform audits of high-risk local government agencies, publicly report the results of those audits, and follow up to determine whether appropriate corrective action has been taken regarding recommendations made by the State Auditor.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

#### **§ 61101. Subchapter Citation**

This chapter and Government Code section 8546.10 shall be known and may be referred to as the High Risk Local Government Agency Audit Program.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

#### **§ 61102. Abuse**

“Abuse” means that a government official acted in a manner that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary given the facts and circumstances. Abuse also includes the misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, a violation of law, regulation, or provisions of a contract or grant agreement.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

#### **§ 61103. Audit Committee**

“Audit committee” means the Joint Legislative Audit Committee.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

#### **§ 61104. Fraud**

“Fraud” means a type of illegal act involving obtaining something of value through willful misrepresentation. Whether an act constitutes a fraud is a determination to be made through the

judicial or other adjudicative system, but the State Auditor may disclose facts that support a legal claim of fraud.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

#### **§ 61105. High risk**

“High risk” means that the State Auditor has determined, based on any of the risk factors set forth in section 61121, that the local government agency has the significant potential for waste, fraud, abuse or mismanagement or has major challenges associated with its economy, efficiency, or effectiveness.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

#### **§ 61106. Local Government Agency**

“Local government agency” means a city, county, city and county, special district, school district, public agency or authority that operates at the local or regional level, or any other political subdivision in the State that operates at the local or regional level. Local government agency includes, but is not limited to, a special district, a joint powers authority whose membership includes representatives of a local agency, a school district, and a county office of education.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

#### **§ 61107. Risk Factors**

“Risk factors” mean the criteria set forth in section 61121 that may be used by the State Auditor to identify a local government agency that is potentially at high risk, or is at high risk, for waste, fraud, abuse or mismanagement or has major challenges associated with its economy, efficiency, or effectiveness.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

#### **§ 61108. State Auditor**

“State Auditor” means the California State Auditor.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

## **§ 61109. Waste**

“Waste” means that spending or investment decisions result in taxpayers not receiving reasonable value in connection with government-funded activities due to an inappropriate act or omission by a government decision maker with control over, or access to, local government resources. Waste has a broader meaning than fraud and abuse and most waste does not involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, and inadequate oversight.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

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

## **Subchapter 2. Identifying a High-Risk Local Government Agency**

### **§ 61120. Information Gathering and Identification**

(a) On an ongoing basis, the State Auditor may review available information, request documents, or conduct interviews of state agency officials, including the State Controller and the Department of Finance, local government agencies, and officials, and may analyze information for the purpose of identifying a local government agency that is at high risk for the potential of waste, fraud, abuse, or mismanagement or that has major challenges associated with its economy, efficiency, or effectiveness. In identifying a potentially high-risk local government agency, the State Auditor shall use the risk factors set forth in section 61121 and shall give the local agency the opportunity to provide its perspective regarding areas of concern.

(b) Based on the analysis performed under this section, the State Auditor may determine that a local government agency is at potential risk for waste, fraud, abuse, or mismanagement or has major challenges associated with its economy, efficiency, or effectiveness.

(c) Upon determining that a local agency is potentially high risk, the State Auditor shall notify the audit committee and the affected local government agency of that determination, as described in section 61122.

(d) Any person may provide the State Auditor with information related to the identification of a high-risk local government agency. To the extent permitted by law, the identity of a person providing information shall be kept confidential.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

**§ 61121. Risk Factors Used to Identify a Potentially High-Risk, or High-Risk, Local Government Agency**

The State Auditor may consider the following risk factors, along with any additional relevant information, including information obtained from a local government agency, when determining whether to designate that entity as potentially high risk or as high risk:

(a) The local government agency's financial report submitted to the State Controller pursuant to Government Code section 53891 or other financial statement, report, or audit indicates that the local agency's financial condition has the potential to impair its ability to efficiently deliver services or to meet its financial or legal obligations. Examples of indicators of an impaired financial condition include, but are not limited to, the following:

(1) The local government agency's ability to pay its short-term obligations on time, using available cash and short-term investments, is uncertain given the extent of its obligations in comparison to cash and investments

(2) The local government agency's ability to meet its long-term obligations, including those stemming from debt issuances, pension plans, and other postemployment benefits promised to its employees, is uncertain given the extent of its obligations in comparison to available resources.

(b) The local government agency's ability to maintain or restore its financial stability is impaired. Indicators of financial stability shall include, but are not limited to, the agency's credit rating, its reliance on potentially unstable sources of revenue, and its ability to raise revenues as necessary to support its commitments.

(c) The local government agency's financial reporting does not follow generally accepted government accounting principles, based on the State Auditor's evaluation of any of the following:

(1) Whether the local government agency uses Generally Accepted Accounting Principles for its financial statements.

(2) Whether the local government agency uses the Comprehensive Annual Financial Report format.

(3) Whether the entity has an unqualified audit opinion.

(4) Whether financial information is reported timely.

(d) Prior audits reported findings related to financial or performance issues regarding a program, service, or activity conducted by the local government agency that indicate the risk of waste, fraud, or abuse, and the agency has not taken adequate corrective action.

(e) The local government agency uses an ineffective system to monitor and track state and local funds it receives and spends, including any funds it passes through to other recipients.

(f) An aspect of the local government agency's operation or management that involves public health or safety, service delivery or fiscal operations is ineffective or inefficient, presents the risk for waste, fraud, or abuse, or does not provide the intended level of public service.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

### **§ 61122. Developing an Audit Proposal**

After identifying a local government agency as having potential risk of waste, fraud, abuse, or mismanagement or having major challenges associated with its economy, efficiency, or effectiveness, the State Auditor shall develop an audit proposal and obtain approval from the audit committee prior to conducting an audit to confirm whether the entity is at high risk for waste, fraud, abuse, or mismanagement or has major challenges associated with its economy, efficiency, or effectiveness.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

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

## **Subchapter 3. Initiating and Performing a High Risk Local Government Agency Audit**

### **§ 61130. Submitting an Audit Proposal to the Audit Committee**

Prior to conducting an audit of a local government agency under this chapter, the State Auditor shall submit the audit proposal developed pursuant to section 61122 to the audit committee and obtain its approval to commence audit work. The State Auditor shall provide the audit committee sufficient information upon which to determine whether to approve the audit. The audit proposal shall identify the local government agency, the identified risk factors, and a general description of the work to be performed. If the audit committee does not approve the audit, the State Auditor may continue to monitor the potentially high-risk local government agency.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

### **§ 61131. Requirements Applicable to Audits**

Upon approval of a high risk local government agency audit by the audit committee, all of chapter 6.5 (commencing with § 8543) of division 1 of title 2 of the Government Code shall apply to the conduct of the audit.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

### **§ 61132. Review of Confidential Draft Audit Reports**

(a) Prior to issuing an audit report under this chapter, the State Auditor shall provide a confidential draft audit report to the appropriate official within the local government agency and allow the official five business days to respond in writing to the report. The State Auditor shall include this written response in the published report. The audit report may or may not conclude that the local government agency should be considered as high risk under this chapter.

(b) The governing body of a local government agency may meet in a closed session pursuant to Government Code section 54956.75 to discuss a confidential draft audit report, including any proposed corrective action plan.

[Note: Authority cited: Section 8546, Government Code. Reference: Section 8546.10, Government Code.]

**[Sections 61133 to 61139 are reserved.]**

## **Subchapter 4. Corrective Action Plans and Removal From the High Risk Local Government Agency Audit Program**

### **§ 61140. Removal From the Program**

To the extent that the State Auditor anticipates issuing an audit report under this chapter designating a local government agency as high risk, the State Auditor shall provide an opportunity for the local government agency to prepare a corrective action plan. This corrective action plan, which is to be included in the audit report, shall outline the specific actions the local government agency shall perform to address the conditions causing the State Auditor to designate it as high risk and the proposed timing for undertaking those actions. The local government agency shall submit written updates and supporting information to the State Auditor within six months of the date the report is published and every six months thereafter regarding its progress in implementing the actions described in its corrective action plan. A local government agency that has not provided its corrective action plan by the time an audit report is published shall provide that plan no later than 60 days after the publication of the report. Upon determining that the corrective action plan has been satisfactorily implemented and the deficiencies identified

in the high risk audit have been satisfactorily addressed, the State Auditor shall notify the audit committee and local government agency, in writing, of the agency's removal from the high risk local government agency program.

[Note: Authority cited: *Section 8546, Government Code*. Reference: *Section 8546.10, Government Code*.]

**[Sections 61141 to 61149, inclusive, are reserved.]**