

**OFFICE OF THE STATE AUDITOR**

**FY 2013 BUDGET**

**NARRATIVE**

December 22, 2011

## **Mission Statement**

The mission of the Vermont State Auditor's Office is to be a catalyst for good government by promoting professional audits, financial training, efficiency and economy in government, and service to cities and towns.

## **Description of Office**

The State Auditor is a constitutional officer, elected biennially by the citizens of Vermont. The Auditor's principal duties are generally defined by 32 V.S.A. §§ 163, 167 and 168. These duties include the following:

- (1) performance of and/or contracting to perform the Federal Single Audit which includes the compliance audit of federal programs and the audit of the state's financial statements;
- (2) discretionary government audits and examinations of any department, institution and agency of the state and certain county officers;
- (3) special audits as requested by the Governor;
- (4) audits or reviews as statutorily required by the Legislature, such as the recent law requiring the audit of the sex offender registry.

## **Guiding Values**

The Vermont State Auditor's Office is dedicated to providing government entities, the Vermont Legislature, and the public with professional audit services that are:

- useful;
- timely;
- accurate;
- objective;
- of high quality;
- audited in a fair manner; and
- performed in conformance with Generally Accepted Government Auditing Standards.

In addition, the Office is committed to improving the professional skills of the staff, sharing knowledge with others, and maintaining a work environment that is ethical, supportive, respectful, collaborative and productive.

## **Significant Recent Achievements of the State Auditor's Office**

As of the end of calendar year 2010, we had successfully completed the move, started in 2008, to become an effective performance auditing office. Calendar year 2011 was the first full year of performance auditing for our office. We completed the following performance audits in FY 2011:

- Southwest Vermont Supervisory Union (SVSU): We hired MGT of America, Inc. to audit the delivery of services within the SVSU. The resulting report contains more than 60 findings and recommendations for the SVSU, which if implemented, should allow it to save more than \$2 million annually.
- Sex Offender Supervision: – Probation & Parole Officers' Caseload: Corrections' caseloads were largely in accordance with statutory requirements, but monitoring tools need improvement. Most of our recommendations were targeted toward improving the accuracy of information in the Corrections system and the usefulness of the applicable reports.

- Newport Tax Increment Financing District: This report found that the City of Newport generally complied with state statutes, but the City miscalculated the total incremental property tax revenue generated by the TIF district and as a result owes the state's education fund \$81,612. In addition to recommending that the City arrange to pay the amount owed to the state's education fund, we also made recommendations designed to improve the City's administration of the TIF district.

### **Statutorily Required Audits and Reports**

In FY2011, the State Auditor's Office completed the following statutorily required audits and reports:

FY 2010 financial statement audit and Single Audit were completed on time in December 2010 and March 2011, respectively. The State received "clean" opinions, but material weaknesses and significant control deficiencies were found and brought to the attention of management. Although we contract with an independent auditing firm to perform much of the work associated with these audits, our staff also provide significant support to these efforts with their time (about 2,000 hours) and expertise.

- *CAFR (Basic Financial Statement Audit)*. This is the Office's most resource-intensive audit. The objective of this audit is to express an opinion on whether the state's financial statements are free of material misstatement and to report on the state's internal controls over financial reporting and compliance with certain provisions of law and regulation.
- *Federal Single Audit*. This annual audit reviews the more than \$1.3 billion Vermont receives annually from the federal government to ensure that it is spent in compliance with all applicable laws and regulations. It is performed by an independent audit firm (KPMG) with the assistance of the State Auditor's Office.

The State Auditor's Office has taken the initiative to work with state agencies to continually monitor whether they have put policies and procedures in place to address audit findings and recommendations resulting from the Single Audit as well as from citizen complaints received by our office. Audit findings that are repeated year after year add to the state's audit costs and, more importantly, indicate management's failure to fix known problems. By committing sustained attention to this issue, the Office hopes to reduce such repetitive and costly findings in the future.

- *Litigation Report for Calendar Years 2010 & 2011*. This report is required by Act 80, Section 22a. It details spending by the Attorney General's Office in defending the state in pharmaceutical regulation litigation. **The total direct litigation cost associated with Act No. 80 as of June 30, 2011, is \$634,678, including \$345,227 in staff salaries and benefits. The court awarded \$1,759,057 in legal fees to Pharmaceutical Research and Manufacturers of America. There are three additional parties to the suit to whom attorney's fees or other amounts may be awarded by the court.**
- Tax Increment Financing (TIF) Audit – Town of Newport
- Department of Corrections – Sex Offender Supervision Audit
- Sexual Abuse Response System Recommended Audit Strategy
- State Job Creation Programs Audit Strategy

In addition to the work listed above, the following performance audits were started in FY2011 and will be completed in FY2012:

- Tax Increment Financing Audit – Town of Milton
- Tax Increment Financing Audit – City of Burlington

### **Other Audits, Reviews and Situation Reports**

As time and staff resources permit, the State Auditor's Office completes performance audits, other reviews and situation reports. These audits, reviews and situation reports are initiated based upon the Office's assessment of risk areas within state government or as a result of whistleblower allegations and requests from legislators. The following reviews and situation reports were completed in FY 2011, or started in FY2011 and will be completed in FY2012.

- Windsor Northeast Supervisory Union/Bethel School District Situation Report
- Barre City School District Situation Report
- Report to Legislature on FY2010 Audit Findings
- Alternate Revenue Sourcing – Bronner Group

### **Other Significant Activities**

Although staff resources are largely devoted to audits, the SAO provides many other valuable services as time and resources allow. For example:

- At the request of five members of the Vermont General Assembly, we undertook a review of certain issues related to monitoring and managing the Decommissioning Trust Fund. Although this work did not constitute an audit, this report contained timely and relevant information to help further the public discourse related to the future of Vermont Entergy and the monies put away for the eventual decommissioning and cleanup of the plant. Our work focused on (1) the State's method for monitoring whether the decommissioning trust fund will have sufficient assets in the future to cover the costs of site cleanup required by the State and (2) the system of controls that Entergy and the State established to safeguard the assets of the decommissioning trust fund. During FY2011, per statutory requirement, we provided two audit strategies to the legislature for their consideration.
- Sexual Abuse Response System Audit Strategy: To encompass the range of issues and organizations related to the State's sexual abuse response system, we proposed a series of 5 possible audits, which if undertaken, would take place over a period of 4-5 years, commencing with audits of sexual abuse prevention programs and special investigative units.
- State Job Creation Programs Audit Strategy: We recommended a series of 3 discrete audits, commencing with a profile audit. Based on feedback we received from the chairs of the House Committee on Commerce and Economic Development and the Senate Committee on Economic Development, Housing and General Affairs and from the Secretary of the Agency of Commerce & Community Development (ACCD), we will gather additional information from ACCD once its strategic and performance planning process is completed, and we will use this information as part of our consideration of whether to pursue the proposed audits.

- In FY2011 we started the process of following up on the implementation of recommendations made during past performance audits. Audit recommendation follow-up is an important internal control function of management and provides important feedback to our office. It is our policy that, as a part of our annual work plan, we follow up on audit recommendations made in performance audits issued by the Office. The follow-up is performed in the years of the second and fourth anniversaries of the audit report. Recommendations not implemented subsequent to the fourth year may continue to be tracked at the discretion of the State Auditor. The follow-up records, including any data provided by the audited agency, will be maintained and will contribute to the annual performance measurement system of SAO.
- Vermont Employment Growth Incentive program: In brief, we found that the Department of Taxes had established some internal controls to ensure that claims and payments were accurate, complete and timely; however, the claims process could benefit from additional written procedures and documented supervisory review.
- The planned follow-up on the BGS performance audit was postponed as they had informed us that they had not addressed any of the audit recommendations.

### **Sheriffs' Departments and Municipalities**

The State Auditor's Office has also worked extensively with municipalities and sheriffs' departments to improve their financial operations. For example, the Auditor's office met once a month for 18 consecutive months with the Vermont Sheriffs and their bookkeepers to revise the uniform accounting manual, develop a uniform chart of accounts and facilitate the adoption of a uniform accounting software. We continue to meet on a bi-monthly basis to focus on accounting issues and to review policies and procedures to insure best management practices. **We have recommended and are working toward a similar process with the county assistant judges to improve county government financial operations.**

- During the course of a year, the SAO receives numerous requests for assistance from municipalities. In some cases there is an ongoing dispute in a town and we facilitate its resolution while in other cases we provide expertise or a sounding board to help address technical financial management issues. As part of this process, we may issue a situation report, which is a tool to gather relevant information and inform citizens and management of the issues involved in the topic under consideration. A situation report is not an audit and expresses no opinion or conclusions. We issued two situation reports in FY 2011. These reports dealt with questions regarding the (1) financial operation of the Barre City School District and (2) finances and management of the Bethel School District and the Windsor Northwest Supervisory Union.
- In June 2011 the State Auditor's Office partnered with the Vermont League of Cities and Towns (VLCT), with the cooperation of the Government Finance Officers Association (GFOA), and the Vermont Municipal Clerks and Treasurers Association (VMCTA) to hold the fourth annual training for financial managers in towns, schools and state government. 151 attendees representing state and municipal organizations, schools, CPA firms, and others came from across the state to hear presentations on Embezzlement in Vermont Municipal Government – how it's done - how to stop it. Planning is under way for the 2012 training scheduled for June 20th.

### **Legislation that impacts SAO effectiveness**

The statutory requirement that this office perform audits of the Tax Increment Finance (TIF) districts, which include Milton, Newport, Winooski and Burlington by the end of calendar year 2011 drained nearly all staff resources not consumed by the work on the CAFR and A-133 audits, allowing for only a minimal

number of performance audits in FY2012. The requirement that these audits be performed by the State Auditor's Office every three years should be reconsidered by the legislature if the Auditor's Office is to be an effective performance measurement office. We recommend that these audits be performed by outside audit firms and paid for with TIF funds.

Including the requirement in new legislation that the SAO will audit a particular program severely limits our small office from auditing programs which have significant financial risk to the state. We agree that the need to audit is important, but the size of our office and budget limitations prevent us from auditing everything. Consideration should be given to requiring agencies to engage outside audit firms to perform the needed audits and to include the audit costs in their budget requests.

### **Key Budget Matters**

The upcoming fiscal year 2013 budget process is once again significantly impacted by Federal requirements to audit programs receiving American Recovery and Reinvestment Act (ARRA) funds. Thirty-one (31) programs had to be audited in FY2012 because they received ARRA funds. Under federal audit guidelines covering ARRA funds and required re-audits due to audit findings, we anticipate that a total of twenty-six (26) programs will require federal compliance audits in FY2013; eleven (11) more than the fifteen (15) A-133 audits that are included in the contract with KPMG. The estimated cost of the 11 additional audits is \$440,000.

### **Funding Targets**

Our funding targets must be viewed together with the Single Audit Revolving Fund (SARF). Title 32, Chapter 3, section 168 of the Vermont Statutes establishes "...a single audit revolving fund within the state treasury, to be administered by the auditor of accounts." This is the state's mechanism to capture the costs of the federal compliance audit, the basic financial statement audit, and other audit services. These costs are billed to all agencies and departments. On 9/29/11, we provided each agency and department with an estimated bill for the audit of FY2012 which is performed and paid for in FY2013.

### **Expenditures**

Office staff salaries and benefits are a major component of our budget, along with the fee paid to the contractor for the CAFR and the A-133 Single Audit. In order to more fully describe the assumptions incorporated into the budget, we will address these items separately.

### **Personal Services**

Salary and Wages - The Office currently has 14 authorized and filled positions. We are asking for funding for these 14 positions in this budget request at a cost for salaries and benefits of \$1,494,375. These include the Auditor and three appointed (exempt) positions and 10 classified positions.

Benefits - Employee benefits for Social Security, retirement and life insurance increase in relative proportion to increases in salary and wages.

### **Non-employee Personal Services**

The most significant component is the fee paid to KPMG for the audit of the state's financial statements and the A-133 audit of federal funds. In order to control the rate of growth in these costs, we entered into

a five-year contract in 2008 at a very competitive price to perform the audits. The contracted price to perform the audit of the CAFR and A-133 audit for the term of the contract is:

<u>Year Audited</u>	<u>Cost</u>
FY2008:	\$1,127,000
FY2009:	\$1,375,000
FY2010:	\$1,392,000
FY2011:	\$1,392,000
FY2012:	\$1,400,000 (current budget request)

The price of the audits for the two option years of FY2013 and FY2014 are \$1,450,000 and \$1,500,000 respectively.

Although we negotiated competitive pricing for the CAFR and A-133 audits, the KPMG contract is premised upon 15 federal program audits per year. Factors that cause the number of program audits to exceed 15, such as ARRA funding and repeat non-compliance findings, will result in increased audit costs.

Due to continuing expenditure of ARRA funds in FY2012, FY2013 will again see an increase in the number of federal programs required to be included in the scope of the A-133 audit beyond the pre-ARRA number of 15. Generally, each program with ARRA funding is required to have an audit. Prior to ARRA, the state's federal programs were audited on a rotational basis (once every 3 years), which typically should result in 15 programs audited each year. We cannot determine at this time exactly how many programs will need to be audited during FY2013; we are estimating, for budget purposes, that 26 programs will be audited, a decrease of three programs from FY2012. Eleven (11) audits over the base contract number of fifteen (15) will result in an estimated additional cost of \$440,000.

Re-audits are another driver of audit costs. FY2011's A-133 audit, which is ongoing, has preliminarily identified 17 federal programs with significant noncompliance findings which may result in repeat audits of these programs. There are a number of programs still being reviewed which may require re-audits. The 17 programs identified to date which would require re-audits in FY 2013 are:

- Medicaid
- TANF
- SNAP
- Adoption Assistance
- DWSRF
- CWSRF
- WIA Cluster\*
- State Fiscal Stabilization Fund
- Child Support Enforcement
- Title I
- Child Nutrition
- State Energy Program
- Energy Efficiency Conservation Block Grant
- State Labor Information System
- Disaster Assistance – presidentially declared disasters
- Child Care Development Fund
- State Fiscal Stabilization Fund

In the last five to seven years four programs have been habitual repeat audit offenders and have cost the state approximately \$180,000 per year in additional audit costs. These programs are:

**Immunization Grants – had a clean audit last year and was not required to be audited this year**

**CDC Technical Assistance – had a clean audit last year and was not required to be audited this year**

**Child Support Enforcement – has not corrected past audit finding and will have to be re-audited next year**

**Highway Planning and Construction – had a clean audit this year and will not be audited next year**

Non-employee personal services also include amounts budgeted for audit specialists hired directly by this office to supplement existing staff skill sets as needed. We are estimating \$80,000 needed for this service in FY2013. This category also includes the projected costs of the audits of the county sheriffs' departments. By statute this Office pays one-third of the cost of the biennial audits, and the full cost of any transition audits. Our cost to audit the sheriff departments is estimated to be \$21,146 in FY 2013.

### **Municipal Investigations**

Non-employee personal services also include special reviews and investigations of municipal officials and/or municipal financial issues performed by this office. One significant impact of the reductions to our general fund appropriations over the past few years is that there are no funds available in FY2013 to cover municipal investigations. \$100,000 has been included in the Attorney General's Office budget to cover the cost of municipal investigations, but does not cover day-to-day assistance by our office on financial management issues.

### **Operating Expenses**

Educational materials – These expenses include the cost of professional literature and audit resource materials.

Rentals – This represents our fee for space allocation. This is our share of the cost allocation from BGS.

Data processing – These costs are also based on cost allocation plans charged by the Department of Information and Innovation.

Dues, Subscriptions, Registrations – This line item includes our cost of continuing professional education (CPE). Under professional standards prescribed by the US Government Accountability Office, each member of the audit staff must complete a specified number of CPE credits on an annual basis. The amount budgeted in this line item reflects the elevation of Auditor staff qualifications, and the reality that CPE is not only required but essential to the effective delivery of audit services.

Travel – Represents estimated cost for staff to travel to audit locations, conferences and trainings.

Processing Hardware / Software – The efficient and effective delivery of audit services relies on the use of technology. For FY2013 we anticipate the replacement / upgrade of computers purchased more than 4 years ago. The budget also includes the renewal of software licenses.

**Conclusion**

Based on our initial analysis of the funding targets provided, it appears that the Office of the State Auditor will be capable of supporting its funded operations within those funding targets.