

OFFICE OF THE STATE AUDITOR

FY 2012 BUDGET

NARRATIVE

As Submitted 1/12/2011

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

In FY2008 the Office changed its focus toward an "accountability office" model, and negotiated a five-year contract with KPMG to perform both the CAFR and the A-133 Single Audit at very competitive prices. This contract allows the office to do more performance audits and special reviews to assess the efficiency and effectiveness of the programs and operations of state government. We developed our plan to transition to performance auditing, including initiating and completing multiple performance audits prior to the end of calendar year 2009, developing and finalizing a performance audit manual, and providing training to all audit staff. As of the end of calendar year 2010, we have (1) successfully completed the move to an effective performance auditing office, (2) issued numerous performance audit reports, (3) completed our performance audit manual and (4) provided two multi-day trainings focusing on performance auditing to all audit staff.

2010 was the first full fiscal year with a significant allocation of audit staff resources to performance audits. We completed several significant projects, including:

- *Issued a performance audit report on the Department of Motor Vehicles:* This report examines the goals and measures the DMV has established to determine how well the goals and measures align to the department's mission and if they achieve the desired outcomes. The report contains a variety of findings and recommendations, including that DMV develop a strategic plan.
- *Department of Economic Development and Vermont Economic Progress Council Performance Measures:* During this performance audit we assessed whether the Department of Economic Development and the Vermont Economic Progress Council have performance measurement systems in place that are used to effectively manage their programs. Further, we ascertained the extent to which the Department and the Council tracked and reported on the success of their respective programs. The report recommends that both entities develop written strategic plans that clearly define how the programs are to help achieve overall objectives and develop a mix of measures that help track progress toward goals.
- *Review of VISION Payments Made During 2007 and 2008 for Improper Payments:* This report provides the results of our review of payments from the VISION system identified by our office using various data-mining techniques. From the \$8 billion in payments made through VISION in 2007 and 2008, 271 transactions totaling \$2.7 million were reviewed by our office. We identified 52 transactions totaling \$263,000 as duplicate payments to vendors, most of which had been recovered by the state.
- *Report on Internal Control Weaknesses discovered during audit of the VISION System for Improper Payments:* This report, a companion to the VISION payment report, evaluated the accounts payable process of 25 departments against the state's accounts payable internal control guidance. Overall, we found that the departments are generally following the state's accounts payable and internal control guidance, but many departments have not implemented some of the key elements of this guidance. This report makes a number of recommendations intended to improve the controls over the accounts payable function and make the process more efficient.
- *Completed a data reliability audit of the Vermont Sex Offender Registry:* This report provides the results of our audit of the state's sex offender registry, which found a significant number of errors in the system. We made recommendations to improve the sex offender registry's data reliability and controls.
- *Completed the FY 2009 state financial statement audit and Federal single audit on time:* Although we contributed a significant number of hours to this contract to keep costs down (2,000 hours in FY2010), KPMG bore the overall responsibility of the audit and contributed the bulk of the staff time. Contracting with KPMG for the financial statement audit has had significant benefits to the SAO and the state as a whole. In particular, audit efficiencies were derived by having a single entity be responsible for both the financial statement audit and the Single Audit. In addition, with a large firm being responsible for the financial statement audit rather than our small office, we have substantially reduced our risks due to staffing limitations while also taking advantage of the specialized accounting knowledge available in such a firm (e.g., pension, pollution remediation, etc.).

Statutorily Required Audits

In FY2010, the State Auditor's Office completed the following statutorily required audits:

- *CAFR (Basic Financial Statement Audit).* 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. The CAFR audit is performed annually

and this year the audit was performed by KPMG with a very significant contribution of hours from our Office. The audit for the period ending June 30, 2009 was completed on time.

- *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.
- *Litigation Report for Calendar Year 2009.* Required by Act 80, Section 22a. This report details spending by the Attorney General's office in defending the state in pharmaceutical regulation litigation.
- *Sex Offender Registry:* As required by Act 58, this is a performance audit of the state's sex offender registry.
- *Vermont Employment Growth Incentive:* 32 V.S.A. §163(10) requires the State Auditor's Office to conduct a biennial audit of the Vermont Economic Growth Incentive program (VEGI). This biennium we conducted a performance audit on the claims review process, during which we found that the process in place to administer claims for VEGI incentives could benefit from additional controls. We made recommendations that, if implemented, should improve the efficiency and consistency of the claims review process and reduce the risk of inaccurate payments.

Other Audits and Reviews

As time and staff resources permit, the State Auditor's Office completes performance audits and other reviews. These audits and reviews are initiated based upon the Office's assessment of risk areas within state government or as a result of whistleblower allegations.

The following performance measurement audits were started in FY 2009 and were completed in FY 2010.

- Department of Motor Vehicles
- Department of Economic Development and Vermont Economic Progress Council
- Improper payments

Other Significant Activities

At the request of members of the legislature, we reviewed whether the Vermont Yankee Decommissioning Trust Fund (DTF) is managed and used in a way that best benefits the State and its citizens. We reported two primary recommendations.

(1) The State should increase the frequency of its fund adequacy reviews to every 2.5 years which would improve the State's capability to perform systematic monitoring and to require that additional funding assurance be provided, if needed.

(2) The State should assess whether the current DTF investment policy reflects an approach that is prudent and if not, suggest implementing guidelines for investment policies of decommissioning trust funds.

This year FY2011 we have 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.

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 will drain nearly all staff resources not consumed by the work on the CAFR and A-133 audits, which will allow 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.

In addition to audits, 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.

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.

In June 2010 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 their second annual training for financial managers in towns, schools and state government. Eighty-two attendees representing state and municipal organizations, schools, CPA firms, and others came from across the state to hear presentations on conflict in the workplace, grants management, enterprise fund accounting, lease agreements, revolving loan programs, fraud risk assessment, and auditing standards.

Planning is under way for the 2011 training scheduled for June 21st.

Key Budget Matters

The upcoming fiscal year 2012 budget process is significantly impacted by Federal requirements to audit programs receiving American Recovery and Reinvestment Act (ARRA) funds. At this time, under federal audit guidelines we anticipate that a total of 33 programs will require federal compliance audits, 18 more than normally anticipated. Fifteen A-133 audits are included in the contract with KPMG. The estimated cost of the 18 additional audits is \$720,000.

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, and this year will reflect the additional audits required as a result of the ARRA funds Vermont has received.

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 15 authorized positions, including one audit staff position we did not request funding for in FY2011. Although there are continuing budget pressures, we are asking for funding for that position for FY2012 at an estimated cost in salary and benefits of \$83,000. The transformation of the office from a financial audit shop to a performance audit office is now complete and the benefit to the state in increased efficiency and effectiveness resulting from additional performance audits out-weigh the cost of the audit position. Therefore we are asking for funding for 15 positions included in this budget request at a budgeted cost of salaries and benefits of \$1,576,162. These include the Auditor and three appointed (exempt) positions and 11 classified positions. Although one funded classified position recently became vacant, candidate searches are on-going to fill that position. As such, this position is budgeted at full value.

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

The prices 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 the expenditure of ARRA funds, FY2012 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 resulted in 15 programs audited each year. We estimate approximately 33 programs will need to be audited during

FY2012 – an 18-program increase over the base contract number requiring an estimated additional cost of \$720,000.

Re-audits are another driver of audit costs. FY2010's A-133 audit identified 16 federal programs with significant noncompliance findings which will result in repeat audits of these programs. There are seven (7) programs still being reviewed which may require repeat audits. The 16 programs which would require re-audits in FY 2012 regardless of receiving ARRA funds are:

Medicaid *
Vocational Rehabilitation *
TANF *
SNAP *
Adoption Assistance *
DWSRF *
Highway Planning and Construction *
WIA Cluster *
Unemployment Insurance *
Employment Services Cluster *
Weatherization *
State Fiscal Stabilization Fund *
Child Support Enforcement *
Formula Grant *
Capitalization Grants- State Revolving Funds *
Public Assistance Grants Cluster

Note: Those programs with an * after their name have ARRA related findings.

A failure to correct the audit findings in these programs promptly in the coming year will result in \$640,000 to \$920,000 in additional audit costs in FY2013; money that could be spent providing needed services.

Four of these programs have been habitual repeat audit offenders and for multiple years have cost the state approximately \$180,000 per year in additional audit costs. These programs are:

Immunization Grants – 7 years (this program had a clean audit this year)

CDC Technical Assistance – 7 years (this program was not audited this year)

Child Support Enforcement – 8 years

Highway Planning and Construction – 5 of last 6 years

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 \$40,000 needed for this service in FY2012). 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 (\$14,133), which we have budgeted for accordingly.

We are required to have a Peer Review of our policies and procedures in FY2012 at an estimated cost of \$11,000.

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 are no funds available in FY2012 to cover municipal investigations.

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. The TIF audits for Winooski and Burlington required to be completed by 12/31/11 will significantly impact our normal travel costs.

Data Processing Hardware / Software – The efficient and effective delivery of audit services relies on the use of technology. For FY2012 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.