

February 7, 2017

2017-406 A

Dear Members of the Assembly Budget Committee:

The California State Auditor (State Auditor) presents for the legislative budget subcommittees this special report, which summarizes audit and investigation reports we issued from January 2015 through December 2016. The purpose of this report is to assist the Assembly Budget Committee in identifying issues it may want to explore in subcommittee hearings. It is intended to provide transparency in what actions, if any, audited and investigated entities have taken in response to our specific findings and recommendations. This report includes the status of actions taken to implement our recommendations as reported to us by the audited and investigated entities and evaluated by our office as of December 31, 2016. To better assist you, we have highlighted those recommendations that remain not fully implemented.

Our policy requests that entities provide a written response to the audit findings and recommendations before the audit report is issued publicly. As a follow-up, state law requires the entity to provide updates on their implementation of audit recommendations, and we request these updates at 60 days, six months, and one year after the report's public release. For investigations, state law requires that an entity report within 60 days of receiving an investigative report and monthly thereafter until it has completed all of the actions it intends to take in response to the recommendations. Further, we follow up with every entity that we determine has not fully implemented one or more recommendations within one year of the issuance of an audit or investigative report and request an update on the entity's plans to implement the outstanding recommendations.

This report is organized by recommendations that fall within the jurisdiction of each of the individual Assembly Budget Subcommittees. For example, the section for the Assembly Subcommittee 2 on Education Finance identifies report recommendations our office made on issues ranging from admission policies for resident and nonresident students at the University of California to the availability of library services in public schools. The section for Assembly Subcommittee 1 on Health and Human Services identifies report recommendations on issues ranging from administering psychotropic medications to children in foster care to vendor fees for in-home respite services.

Please note that some reports may involve more than one issue or cross the jurisdictions of more than one subcommittee. In Table 1, we provide the report title, recommendations, and action taken by the entity. A more detailed description of the State Auditor's assessment of the entity's actions can be accessed on our website at www.auditor.ca.gov under the "Publications" tab.

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Our audit efforts bring the greatest return when the entity acts upon our findings and recommendations. Table 2 summarizes the monetary value associated with certain findings from reports we issued during the period January 1, 2009, through December 31, 2016. We have indicated the nature of the monetary value in the following categories: cost recovery, cost savings, cost avoidance, increased revenue, and wasted funds. We estimate that if entities implemented our recommendations contained in these reports, they could realize more than \$1.9 billion in monetary value either by reducing costs, increasing revenues, or avoiding wasteful spending.

For example, in our November 2016 report on an audit concerning Los Angeles County's (county) oversight of the Los Angeles County Fair Association (association), we reported that the county exercised weak oversight of its lease with the association. The county has a lease with the association that allows the association to operate the Los Angeles County Fair and requires the association to pay rent to the county based on a percentage of the revenue the association receives from its activities on this land. We found that although the association owns a hotel that operates on county-owned land, the county allowed the association to exclude its hotel's revenue from its rent calculation for reasons that the county could not adequately explain. Consequently, the county likely relinquished more than \$6 million in rent revenue from 2006 through 2015.

In another example, in April 2016 we reported that regular evaluation of corporate income tax expenditures—tax benefits for qualifying corporations—would improve their efficiency and effectiveness. These tax expenditures include exemptions from certain taxes, deductions from taxable income, credits that reduce total tax liability, and elections that allow a choice in how taxes are calculated such as the water's edge election. The water's edge election allows corporations to exclude from their reportable income what they derive from the foreign portions of their business, but may also provide unintended benefits that reduce state revenue, such as allowing corporations to shield income in offshore tax havens. We reported that extending the water's edge to countries considered tax havens, as other states have done, could result in additional state revenue of \$20 million to \$40 million without violating the purpose of the tax expenditure.

We believe the State's budget process is a good opportunity for the Legislature to explore these issues in a public forum and, to the extent necessary, reinforce the need for corrective action. If you would like more information or assistance regarding this report, please contact Paul Navarro, Chief of Legislative and Governmental Affairs, at (916) 445-0255.

Respectfully submitted,



ELAINE M. HOWLE, CPA
California State Auditor