



CONSENT CALENDAR
June 28, 2011

To: Honorable Mayor and Members of the City Council
From: Ann-Marie Hogan, City Auditor
Subject: State Audit Legislation

RECOMMENDATION

Adopt a Resolution stating that the following bills need amendment: SB 186 (Kehoe and DeSaulnier), SB 449 (Pavley), AB 187 (Lara and Smyth), AB 229 (Lara), and AB 253 (Smyth). The City's position on these bills would be that they must be amended to address the concerns listed below. Request the City Manager send this resolution to the sponsors and co-sponsors of these bills, the League of California Cities, and the legislative offices of Senators Hancock and Corbett, Assembly Members Skinner, Buchanan, and Swanson, and staff of the Senate Government Operations Committee and Senate Government and Finance Committee, or other committees that may be considering these bills at the time of this action.

FISCAL IMPACTS OF RECOMMENDATION

There are minimal costs involved in sending letters. There could be significant future costs to the City, if these bills pass without amendment.

CURRENT SITUATION AND ITS EFFECTS

These five bills could authorize new State mandated costs for California local governments, including the City of Berkeley. They are currently being discussed and amended in Sacramento. SB 186, SB 449, and AB 229 authorize the elected State Controller to conduct audits of local governments or their auditors and, according to an analysis by the League of California Cities, to charge the local governments for the audit services. AB 187 gives that same authority to the appointed State Auditor. AB 187 was recently amended to add language about the State Auditor costs but, as of June 13, the League position is that it is not yet clearly stated in all of these bills that local governments will not be charged for the State's audit services. AB 229 and AB 253 could impose new indirect costs on the City by raising costs for the annual CAFR and Single Audits performed by a public accounting firm, and by imposing new State mandates regarding how the City performs its accounting and auditing functions. See www.leginfo.ca.gov for: [SB 186](#); [SB 449](#); [AB 187](#); [AB 229](#); and [AB 253](#).

It should be noted that changes to each of the bills could be in place before the date of this Council meeting, since Berkeley's Open Government Ordinance requires that Council items be published well in advance of meetings. The League of California Cities is also anticipating voting on its positions on these bills shortly. The City Auditor will provide updated information as needed.

BACKGROUND

The scandals in the City of Bell have inspired numerous legislative proposals to improve state fiscal monitoring and auditing of local governments. The League of California Cities identified a need to adopt specific Audit Principles to assist them in addressing these bills, and staff requested assistance from the City Auditor in developing these Audit Principles, which have now been adopted by the League. The League staff also asked the City Auditor to obtain comments from the independent performance audit community about some of the bills. These bills include SB 186 (Kehoe and DeSaulnier), 449 (Pavley), AB 187 (Lara and Smyth), AB 229 (Lara), and AB 253 (Smyth). (Source: www.leginfo.ca.gov)

1. SB 186 (Kehoe and DeSaulnier) authorizes the State Controller to perform audits of local agencies.
2. SB 186 (Kehoe and DeSaulnier) and SB 449 (Pavley) authorizes the State Controller to review local agency finances and audit local agency records.
3. AB 187 (Lara and Smyth) authorizes the State Auditor to establish a high-risk local agency audit program and audit to local agencies.
4. AB 229 (Lara) authorizes the State Controller to review and monitor audit reports performed by “independent auditors” and to prescribe an audit guide for these audits.
5. AB 253 (Smyth) establishes a Committee on City Accounting Procedures and requires the State Controller, in consultation with the Committee, to prescribe uniform accounting procedures to cities.

Published analysis indicates that 186 and 449 could authorize the Controller to charge the local agency (i.e., city) for the audits. The Controller is currently charging the Oakland Unified School District for such audit services, and an Assembly Bill challenging these charges is currently under consideration.

These bills should be amended to specifically prohibit charges to the local agencies, and to conform with the League of California Cities Audit Principles, and to address the following specific concerns:

1. **Unfunded Mandate: (SB 186, SB 449, AB 229)** The bills should be amended to clearly state that local governments will not be required to pay for the services for the State Controller or State Auditor nor to pay unreasonable costs for annual audit fees.
2. **Auditing Standards: (SB 186, SB 449, AB 187, and, possibly, AB 229)** The bills should require any audits of local agencies performed by the State Controller or the State Auditor to be conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Controller General of the United States and the Government Accountability Office (GAO)

3. **Auditing Standards: (AB 229 and AB 253)** Since local governments and their auditors are already obliged to comply with federal standards, amend AB 229 to make the proposed California “audit guide” and the “uniform accounting procedures” voluntary guidance, rather than a new set of requirements.
Criteria for Selection for or Exemption from Audit: Require that criteria for selection of which local agencies to audit and how agencies get off the “high-risk” or audit-target list be spelled out more specifically in the legislation.
4. **Criteria to include in determining risk level or exemption from audits under these bills: (SB 186, SB 449, and AB 187)**
 - a. Excellent bond ratings.
 - b. Establishment by local statute/charter or enhancement of both an independent audit committee and a local independent performance audit function reporting to the independent audit committee, the legislative body, or to an elected auditor.
 - c. Other criteria such as those included in SB 449 and as may be suggested by knowledgeable parties.
5. **Define “Independent Auditors”:** Amend **AB 229** as shown in attached change tracked version of the bill, to make the language more consistent, which will clarify that oversight of the commercial accounting firms’ annual financial audits does not include oversight of performance audits by independent local auditors who are employees of their jurisdictions.
6. **Role of City Auditors:** Generally speaking, bills should be crafted to support establishment and improvement of independent local government audit committees and performance audit functions. City, county, and district auditors can help support the State’s interest in improving governance and performance of local governments. Such audit functions are required to follow GAGAS or IIA auditing standards, by California Government Code section 1236 and some City charters, including the Berkeley City Charter. Section 1236 already requires all local agencies with an aggregate spending of fifty million dollars or more annually to consider establishing an ongoing audit function in each agency. Whether agencies are aware of this requirement is unknown.

RATIONALE FOR RECOMMENDATION

The City of Berkeley, as well as other local agencies, will avoid the risk of incurring future costs because of the potential unintended consequences of these bills.

ALTERNATIVE ACTIONS CONSIDERED

The City could vote to “Oppose” these bills or to “Oppose Unless Amended.” Generally, when a position is taken to oppose unless amended, the expectation would be that the amended bill would be supported. Given legislative timing constraints, it would not be practical for the City to enter into negotiations with the authors of these bills with an aim of changing the City’s position to “Support.”

CONTACT PERSON

Ann-Marie Hogan, City Auditor, Office of the City Auditor, 981-6750

Attachments:

- 1: Resolution
- 2: League of California Cities Audit Principles (adopted 2011)
- 3: AB 229 (with previously suggested changes)
- 4: [SB 186](#) as of June 13, 2011
- 5: [SB 449](#) as of June 13, 2011
- 6: [AB 187](#) as of June 13, 2011
- 7: [AB 229](#) as of June 13, 2011
- 8: [AB 253](#) as of June 13, 2011

Supplemental Materials:

- 1: Links to legislative updates and history on all bills to be found at <http://www.leginfo.ca.gov>

RESOLUTION NO. ##,###-N.S.

AMENDMENTS NEEDED: SB 186, SB 449, AB 187, AB 229, AB 253

WHEREAS, the events in Bell, California have inspired numerous bills in the State Assembly and the State Senate aimed at preventing such abuses of authority in other local governments; and

WHEREAS, some of these bills contain language that, in the opinion of the City Auditor and representatives of other local government auditors and agencies, may trigger costly unintended consequences; and

WHEREAS, public confidence in government is maintained and strengthened when auditors perform their work with independence, objectivity, and integrity, and in accordance with nationally recognized professional auditing standards; and

WHEREAS, the League of California Cities, with assistance from the Berkeley City Auditor and the Association of Local Government Auditors (ALGA), has drafted an approved Audit Principles for use in considering legislation affecting audits; and

WHEREAS, the City Auditor and members of ALGA are available to advise in the process of amending these bills.

NOW THEREFORE, BE IT RESOLVED by the Council of the City of Berkeley that SB 186, SB 449, AB 187, AB 229, and AB 253 should be amended rather than approved in their current form, as follows:

1. **Unfunded Mandate: (SB 186, SB 449, AB 229)** The bills should be amended to clearly state that local governments will not be required to pay for the services for the State Controller or State Auditor nor to pay unreasonable costs for annual audit fees.
2. **Auditing Standards: (SB 186, SB 449, AB 187, and, possibly, AB 229)** The bills should require any audits of local agencies performed by the State Controller or the State Auditor to be conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Controller General of the United States and the Government Accountability Office (GAO)
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 - a. Excellent bond ratings.
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 - c. Other criteria such as those included in SB 449 and as may be suggested by knowledgeable parties.
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BE IT FURTHER RESOLVED that this Resolution be communicated to the authors and co-authors of each bill, as well as the State Controller, State Auditor, League of California Cities, local State representatives, and staff of the legislative committees considering these bills at the time of passage of this Resolution.