STATE OF ALASKA

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

ANNUAL REPORT

2014

LEGISLATIVE BUDGET AND AUDIT COMMITTEE

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LEGISLATIVE AUDITOR
Kris Curtis, CPA, CISA

LEGISLATIVE FISCAL ANALYST
David Teal

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28th Alaska State Legislature
Legislative Budget & Audit Committee

January 19, 2015

Members of the Legislature

Fellow Members:

In accordance with AS 24.20.311, the following is the 2014 report of the Legislative Budget and Audit Committee. This report outlines the responsibility of the Legislative Budget and Audit Committee and its two professional divisions, the Division of Legislative Audit and the Division of Legislative Finance.

Copies of each audit report and performance review report released during 2014 are on file in the senate and house chambers, the two finance committees, the Division of Legislative Audit, various libraries throughout the State, and at http://legaudit.akleg.gov/.We encourage all legislators to utilize this valuable information.

The Legislative Budget and Audit Committee wishes to thank the legislature for its support in 2014.

Respectfully submitted,

Legislative Budget and Audit Committee

Senator Anna MacKinnon, Chair

Representative Mike Hawker, Vice Chair

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ORGANIZATION AND FUNCTION

The Legislative Budget and Audit Committee is a permanent interim committee of the Legislature. It was established in 1955 as the Legislative Audit Committee. The committee is composed of 10 members and two alternates: the chairpersons of the senate and house finance committees; one member selected from each of the senate and house finance committees and appointed by the President of the Senate and the Speaker of the House, respectively; and three members and an alternate appointed from each house by the respective presiding officer. If the chairperson of a finance committee chooses not to serve, the presiding officer appoints a replacement from the finance committee. Alternate members are also appointed from the finance committees.

The committee has the responsibility for providing the legislature with fiscal analysis, budget reviews, audits and performance reviews of state government agencies, and for approving requests from the governor to revise the *Appropriations Act*. As a result of the passage of Ch. 18, SLA 1980, the committee has authority to monitor lending and investment activities of the State.

To provide the necessary technical assistance to accomplish the purposes, two permanent staff agencies have been created: the Division of Legislative Finance and the Division of Legislative Audit. These divisions report directly to the Legislative Budget and Audit Committee and are independent of executive and judicial agencies. The committee also has several authorized positions to assist with committee activities.

Division of Legislative Finance

One of the primary responsibilities of a state legislative body is to research, draft, and enact revenue and appropriation measures. The Legislative Finance Division has the following statutorily assigned responsibilities to support the legislative budget process:

1. Analyze the budget and appropriation requests of each department, institution, bureau, board, commission, or other agency of state government.

2. Analyze the revenue requirements of the State.

3. Provide the legislative finance committees with comprehensive budget review and fiscal analysis services.

4. Cooperate with the Office of Management and Budget in establishing a comprehensive system for state program budgeting and financial management as set out in the *Executive Budget Act* (AS 37.07).

5. Complete studies and prepare reports, memoranda, or other materials as directed by the Legislative Budget and Audit Committee.

6. With the governor's permission, designate the legislative fiscal analyst to serve ex officio on the governor's budget review committee.

7. Identify the actual reduction in state expenditures in the first fiscal year following a review under AS 44.66.040 resulting from that review and inform the Legislative Budget and Audit Committee of the amount of the reduction.

8. Not later than the first legislative day of each first regular session of each legislature, conduct a review in accordance with AS 24.20.235 of the report provided to the division under AS 43.05.095.

The Legislative Finance Division reviews proposed changes to the operating budget and provides the Budget and Audit Committee with an analysis of proposed "*revised programs*" for committee decisions.

The Legislative Finance Division is staffed by the legislative fiscal analyst (director), five fiscal analysts, information technology staff, and an administrative officer. Division staff also includes the finance committee secretaries and, for budgetary purposes, the finance aides assigned to committee members.

Division of Legislative Audit

In accordance with the Constitution of the State of Alaska and Title 24 of the Alaska Statutes, the legislative auditor and staff conduct the post-audit function in the budget cycle**.** The Division of Legislative Audit was created in 1955.

All audits performed by the division are external audits; that is, they are performed by an auditor who is independent of the executive head of the government unit or agency being audited. The three major types of audits performed by the division are financial-compliance, performance, and special reports.

1. Financial-Compliance Audit

A financial-compliance audit determines (a) whether financial operations are properly conducted; (b) whether the financial reports of an agency are presented fairly; and (c) whether the entity has complied with applicable laws, regulations, administrative policies, and legislative intent.

2. Performance Audit

A performance audit is conducted to provide the legislature with an evaluation on the manner in which administrators of an agency have faithfully, efficiently, and effectively administered a program. *Faithfulness* refers to whether or not programs have been administered in accordance with promises made to the legislature and the expression of legislative intent. *Effectiveness* refers to whether or not planned program objectives have been achieved. *Efficiency* refers to whether or not program accomplishment has been achieved by using the least-cost combination of resources with a minimum of waste.

The 1971 legislature gave the Division of Legislative Audit the authority to conduct performance audits of any agency of state government at the direction of the Legislative Budget and Audit Committee. The committee has instructed the legislative auditor to review all audit assignments and conduct performance audits whenever considered practical and beneficial to the State.

The 1977 legislature passed a "*sunset law*" which requires the division to conduct performance audits of boards, commissions, and agency programs subject to termination under AS 44.66. The audit report, along with other reports and testimony, is considered when determining if there is a public need for a board, commission, or program.

3. Special Audit Report

All special audits are conducted at the request of the committee. Any member of the legislature may request a special audit through the committee. A special audit can cover many things. It can be an audit that is restricted to one part of an agency's operations or it can be an audit reviewing financial transactions for a period of time shorter or longer than a fiscal year. The special audit often results in an information type report.

The Division of Legislative Audit also facilitates performance reviews as required by HB 30, enacted by the Alaska State Legislature in 2013. Performance reviews are systematic assessments of the appropriateness, effectiveness, and efficiency of a department; and are meant to provide information for policy makers, executive branch management, and the public.

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ALASKA STATE LEGISLATURE
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SUMMARY OF: State of Alaska, Single Audit for the Fiscal Year Ended June 30, 2013

PURPOSE AND SCOPE OF THE REPORT

This report summarizes our review of the State of Alaska's basic financial statements and the State's compliance with federal laws and regulations in the administration of approximately $3.3 billion of federal financial assistance programs. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. It also complies with the federal *Single Audit Act Amendments of 1996* and the related *United States Office of Management and Budget Circular A-133*.

The report contains an opinion on the basic financial statements of the State of Alaska for FY 13, recommendations on financial and compliance matters, auditor's reports on internal controls and compliance, the Schedule of Expenditures of Federal Awards, and the Summary of Prior Audit Findings.

REPORT CONCLUSIONS

The basic financial statements for the State of Alaska are fairly presented in accordance with accounting principles generally accepted in the United States of America without qualification. Additionally, the State's FY 13 *Comprehensive Annual Financial Report* includes a Certificate of Achievement for Excellence in Financial Reporting which is presented by the Government Finance Officers Association.

The State of Alaska did not comply with *Federal Funding Accountability and Transparency Act* (FFATA) reporting requirements applicable to the Social Services Block Grant (SSBG; CFDA 93.667) administered by the Department of Health and Social Services. Failure to comply with FFATA reporting requirements resulted in a material weakness and material noncompliance for the SSBG program. The State has substantially complied with the applicable laws and regulations in the administration of its other major federal financial assistance programs. The report does contain recommendations regarding significant deficiencies in the State's internal control over financial statements and federal programs.

FINDINGS AND RECOMMENDATIONS

This report contains 53 recommendations, of which 20 are unresolved issues from last year. One of the 53 recommendations is made to Alaska Energy Authority whose audit was performed by other auditors. Some of the recommendations made in this report require significant changes in procedures or a shifting of priorities and, therefore, may take more than one year to implement. The Summary Schedule of Prior Audit Findings in Section III identifies the current status of most prior audit recommendations not resolved by the release of the FY 13 statewide single audit.

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SUMMARY OF: A Special Report on the Department of Revenue, Oil and Gas Tax Audit Process, June 20, 2014

PURPOSE OF THE REPORT

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we have conducted a performance audit of the Department of Revenue's (DOR) oil and gas tax audit process. This audit evaluates the effectiveness of DOR's oil and gas production tax audit group (audit group) by comparing audit processes used for relevant tax structures and by comparing the current process to industry best practices. Impediments to the audit process were identified and recommendations for improvements were made. The audit also examined DOR staff's professional qualifications and assessed whether resources were sufficient to address the audit backlog.

REPORT CONCLUSIONS

In summary, the audit concluded that under Petroleum Production Tax (PPT) and Alaska's Clear and Equitable Share (ACES), fewer tax return audits were conducted, and audits took an average of 2.5 times longer to complete than under the Economic Limit Factor. Despite fewer completed audits, PPT and ACES audits continued to cover a significant portion of annual tax liabilities and resulted in $488 million in assessments for the 2006 and 2007 tax years.

The audit found that oil and gas auditors were qualified to perform audit functions and auditors met the minimum education and experience requirements for their positions. However, productivity and effectiveness could be improved by implementing a formal training program.

As of March 31, 2014, the audit group had a backlog of 55 tax return, 023 credit, and 025 credit audits. While DOR's backlog of credit audits can be addressed by current resources, it is unclear if DOR will be able to address the backlog of tax return audits. DOR management is confident of its ability to address the backlog. However, our audit does not support management's level of confidence. Given the number of planned audits and the impediments to the audit process identified as part of this audit, there is a risk that DOR will not be able to meet its audit mandate. This risk can be mitigated by implementing improvements to the audit process.

Overall, the audit concluded that the audit group's processes do not follow best practices applied by the auditing profession and other states in five areas: project management, risk assessment, materiality, audit documentation, and taxpayer communication. Implementing auditing best practices could improve DOR's audit quality and timeliness. (See Recommendation No. 1.)

The Tax Division is implementing the Tax Revenue Management System (TRMS) which could address several findings identified above. However, because the system is in the early development stages and the oil and gas production tax configurations have not been defined, the TRMS' success in addressing these issues is difficult to predict.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The Tax Division director should ensure the procedures for conducting oil and gas audits incorporate best practices.

DOR audit and review procedures do not reflect auditing best practices in the following areas: project management, risk assessment, materiality, audit documentation, and taxpayer communication. Applying best practices may help the audit group comply with the statutory time limit by improving audit efficiency and effectiveness.

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SUMMARY OF: A Special Report on the Department of Revenue, Alaska Film Production Incentive Program, July 14, 2014

PURPOSE OF THE REPORT

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we have conducted a performance audit of the Alaska Film Production Incentive Program (film credit program).

This performance audit evaluates the Alaska Film Office's (AFO) compliance with statutes and regulations in conducting the activities of the film credit program from July 1, 2013, through June 30, 2014. The audit also provides the current status of recommendations from the prior two performance audits.

REPORT CONCLUSIONS

The audit concludes:

- Statutory dollar limits for the film credit program were not exceeded.

- Except for the statutory requirement to obtain names of the proposed cast, applications for qualification were approved or rejected in accordance with statutes. The related internal controls were found to be operating effectively.

- Final applications for film tax credits subject to the original statutory framework were approved in accordance with applicable statutes and regulations. The related internal controls were found to be operating effectively.

- Except for the statutory requirement for film productions to include the AFO logo and required verbiage, final applications for film tax credits subject to the new framework were approved in accordance with applicable statutes. The related internal controls were found to be operating effectively.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The Department of Revenue's (DOR) AFO executive director should continue efforts to ensure qualification applications contain names of the proposed cast as required by statute.

All 29 qualification applications approved since July 1, 2013, were examined to determine if the applications included names of the producers, directors, and proposed cast. Seven of the 29 qualification applications were incomplete in listing talent or persons highlighted in the film production.

Recommendation No. 2

DOR's AFO executive director and the film commission should ensure that film credit productions include the AFO logo and the required statutory verbiage.

Film productions related to the two final applications approved after July 1, 2013, and subject to the new statutory framework did not include the AFO logo and the words "*Filmed in Alaska with the Support of the State of Alaska*" as required by statutes.

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SUMMARY OF: A Sunset Review on the Department of Commerce, Community, and Economic Development, Alcoholic Beverage Control Board, May 30, 2014

PURPOSE OF THE REPORT

In accordance with Title 24 and Title 44 of the Alaska Statutes (sunset legislation), we have reviewed the activities of the Department of Commerce, Community, and Economic Development's (DCCED) Alcoholic Beverage Control Board (board). The purpose of this audit was to determine if there is a demonstrated public need for its continued existence and if it has been operating in an effective manner. As required by AS 44.66.050(a), this report shall be considered by the committee of reference during the legislative oversight process in determining whether the board should be reestablished. Currently, under AS 44.66.010(a)(1), the board will terminate on June 30, 2015, and will have one year from that date to conclude its administrative operations.

REPORT CONCLUSIONS

We conclude that the board's termination date should be extended. The board is serving the public's interest by effectively licensing and regulating the manufacture, barter, possession, and sale of alcoholic beverages in Alaska. The board has demonstrated a need for its continued existence by protecting the general public through the issuance, renewal, revocation, and suspension of alcoholic beverage licenses. Protection has also been provided through investigations of suspected licensing violations and enforcement of the State's alcoholic beverage control laws and regulations.

We conditionally recommend that the board's termination date be extended five years to June 30, 2020. If the marijuana voter initiative passes, we recommend a shorter extension of no more than three years as the initiative significantly expands the board's duties.

FINDINGS AND RECOMMENDATIONS

The prior sunset audit included three recommendations. Two prior recommendations have been resolved, and the other has been partially resolved and is reiterated as parts of Recommendation Nos. 1 and 2. This report makes three new recommendations.

1. The board's director should ensure that all board meetings are properly published on the State's Online Public Notice System.

2. The board should notify local governing bodies of applications for new and transfer licenses within 10 days of receipt.

3. The board should issue catering permits in accordance with statutory requirements.

4. The board should issue recreational site licenses in accordance with statutory requirements.

5. The board should implement a process to monitor and track all complaints to ensure they are resolved in a timely manner.

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SUMMARY OF: A Sunset Review on the Department of Commerce, Community, and Economic Development, Board of Certified Direct-Entry Midwives, June 30, 2014

PURPOSE OF THE REPORT

In accordance with Title 24 and Title 44 of the Alaska Statutes (sunset legislation), we have reviewed the activities of the Department of Commerce, Community, and Economic Development's (DCCED) Board of Certified Direct-Entry Midwives (board). The purpose of this audit was to determine if there is a demonstrated public need for the board's continued existence and if it has been operating in an effective manner. As required by AS 44.66.050(a), this report shall be considered by the committee of reference during the legislative oversight process in determining whether the board should be reestablished. Currently, under AS 08.03.010(c)(8), the board will terminate on June 30, 2015, and will have one year from that date to conclude its administrative operations.

REPORT CONCLUSIONS

Overall, the audit concluded that the board is serving the public's interest by effectively licensing certified direct-entry midwives (CDM) and apprentices. Furthermore, the board worked to improve the profession by modifying and adopting midwifery regulations to conform with current standards of care. The audit also concluded that Division of Corporations, Business and Professional Licensing (DCBPL) staff failed to operate in the public's interest by not pursuing timely disciplinary sanctions related to four CDM investigations. We recommend the board's termination date be extended only two years to June 30, 2017. The reduced extension recommendation is due to significant deficiencies by DCBPL staff in pursing disciplinary sanctions.

FINDINGS AND RECOMMENDATIONS

1. DCCED's commissioner should take immediate action to pursue disciplinary sanctions for CDM cases when warranted.

2. DCBPL, in consultation with the board, should increase licensing fees to eliminate the board's operating deficit.

3. The board should communicate certificate requirements to continuing education providers to facilitate compliance with centralized licensing regulations.

4. The board should approve apprentice permit applications in accordance with statutes.

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SUMMARY OF: A Special Report on the Department of Commerce, Community, and Economic Development, Regulatory Commission of Alaska FY 13 Annual Report, May 16, 2014

PURPOSE OF THE REPORT

In accordance with Title 24 of the Alaska Statutes and a special request by the Legislative Budget and Audit Committee, we have conducted a performance audit of the Regulatory Commission of Alaska's (commission or RCA) FY 13 annual report.

REPORT CONCLUSIONS

Overall, the audit found the commission accurately reported on the status of utility dockets, pipeline dockets, statutory extensions, and complaint resolution and consumer outreach performance measures. Data reported in the FY 13 annual report for tariff filings, regulatory dockets, and the timeline performance measure was not reliable due to errors in the underlying case management system data.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The RCA chair should continue to implement and enforce written procedures to ensure case management system data is consistent, complete, and accurately reflected in the annual report.

RCA's FY 13 annual report contains errors in tariff filing and regulatory docket information. An examination of 75 of 318 tariff filings and two of 12 regulatory dockets open or opened during FY 13 found case management system data error rates of 21 percent and 50 percent respectively.

Although commission management developed written procedures for entering tariff filing and docket data during FY 12, testing results showed procedures were not consistently applied. The data errors can be attributed to a lack of adequate training and documentation of data review and lack of ongoing quality reviews.

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SUMMARY OF: Performance Review of the Alaska Department of Corrections, December 2, 2104, Conducted and Issued by CGL

PURPOSE OF THE REPORT

In accordance with Title 44 of the Alaska Statutes, we have facilitated the first performance review of the Department of Corrections (DOC). The purpose of the performance review was to analyze the overall effectiveness and efficiency of DOC while focusing on 17 review objectives. The review team analyzed DOC's performance and policies and compared them against national best practices.

KEY FINDINGS

- DOC is moderately effective in meeting its objectives of providing secure confinement and supervised release.
- DOC is highly effective in providing reformative programs, but the effectiveness of the actual programs is unknown due to a lack of research staff to study program outcomes.
- DOC's delivery of secure confinement, reformative programs, and supervised release is efficient.
- DOC's delivery of healthcare appears to be adequately and efficiently managed, but policies and procedures have significant omissions that could affect the quality of services provided.
- DOC lacks information, such as a long-range facilities master plan and a current prison system population forecast, for policy makers to use to make informed decisions.
- DOC did not provide a specific list of proposed General Fund budget reductions as required by performance review statutes. DOC concluded that the only way to achieve a ten percent reduction would be to close a correctional facility, and provided FY 15 authorized funds for each correctional facility.

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