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State Controller's Office
Testimony to the Little Hoover Commission
Bond Oversight Hearing – September 25, 2008

Members of the Commission, thank you for inviting the State Controller to this hearing today. My name is Dave O'Toole and I am appearing today on the Controller's behalf with our audit experts, Michael Carter, our Chief Operating Officer; Jeff Brownfield, Chief of our Division of Audits; and John Chen, Chief of Special Projects for that division.

I serve as the Controller's Deputy Legislative Director and in that capacity I staffed Senate Bill 784, a bond oversight bill authored by Senator Torlakson and sponsored by this office and the State Treasurer's Office.

In my remarks I'd like to tell you about SB 784; our role in auditing the bonds and establishing a Citizen's Bond Oversight Committee; explain our history with bond audits; and share our thoughts about oversight of the Propositions 1B through 1E and Proposition 84 bonds approved back in November 2006.

As introduced, SB 784 would have enabled our office to audit \$42.6 billion in general obligation bonds for school construction, transportation systems, parks and levees, and affordable housing, as well as establish a Citizens' Bond Oversight Committee to review bond expenditure plans and projects.

Through the same bill, the Treasurer's Office would have established a project database in an online, searchable format where citizens could track progress.

It's no understatement to say that the \$42.6 billion in general obligation bond authority was an unprecedented infrastructure investment in California history. Our office believes that investment warrants an unprecedented commitment to oversight and accountability.

Let me begin with the Citizens' Bond Oversight Committee. The eleven-member C.B.O.C. Controller Chiang and Treasurer Lockyer proposed would have included a minimum of eight public citizens to review and report on all aspects of the bond expenditures. (The Controller, Treasurer, and Director of Finance would be the other members.) The Commission would provide necessary independent oversight and work to assure Californians that public works projects financed by the initiatives would be on-time and within budget, operate efficiently, and contain no wasteful spending.

Unfortunately, during deliberations on the bill we encountered strong opposition from the Administration and we agreed to remove the C.B.O.C. from that particular bill in hope of seeing the rest enacted that year.

The audit provisions of SB 784 would have allowed our office to audit particular projects and make recommendations to the Legislature and Administration on how to improve project implementation. Audits would be paid for out of bond funds, either through direct expenditures or through the existing administrative set-asides. The legislation also required the Controller to prepare a bond audit plan for the Legislature and Administration, where he or she would lay out findings and recommend ways to improve implementation of projects, as well as his or her audit plan for the subsequent fiscal year.

SB 784 would have complemented—not replaced—the Governor’s Executive Order S-02-07, which laid out an “accountability structure” for these bond funds. Importantly, that bill would provide an additional *independent* oversight of bond expenditures.

As the Controller noted at the time the bill was introduced, “The Governor’s plan on oversight is a positive first step, but we think the guidelines directed to government agencies that spend the funds can go even further. We should strongly support citizen participation in the fiduciary stewardship of these public funds.”

The Controller has the authority and experience to effectively carry out the oversight envisioned in the bill.

Under state law he has the sole responsibility in determining and reviewing the legality and accuracy of state expenditures. Regarding the audit of general obligation bonds specifically, in 2004 we audited L.A. Unified School Districts’ \$2.4 billion Proposition BB bond funds for school construction and repairs. We found more than \$27.9 million in ineligible costs, and numerous process and management shortcomings. Overall, we noted that their construction program lacked funding to complete all projects planned.

More recently (and notwithstanding the failure of SB 784 to be enacted), the Department of Transportation contracted with us for 20 audit personnel to audit the \$20 billion in Prop 1B expenditures.

This contract suggests the Administration is without the resources and experience to audit the \$42.6 billion in expenditures and is looking for partners. We maintain that the audit provisions of SB 784 remain relevant and point the way to ensuring the best use of those bond dollars.

Fiscal concerns were often raised against the bill. We responded that the estimated cost of 10 new auditor positions, \$1 million, which be drawn from the administrative share of the bond proceeds—not General Fund and a relatively insignificant cost in comparison with the \$42.6 billion in bond expenditures to be disbursed.

Based on past audit exception rates, cost savings identified through the audits would far more than offset any expense. Over the last four fiscal years, the SCO’s ratios of audit exception to audit costs were 17:1, 12:1, and 10:1, and 13:1, with an average exception rate of 13:1.

Given the enormous scope of funding overseen by the 10 auditors, savings were expected yield an even higher average exception rate—freeing up tens of millions in project funds.

Finally, to address your question about the existence of models for bond oversight, the C.B.O.C. had clear precedent. Citizen-led school bond spending oversight committees have overseen hundreds of millions and even billions of dollars in school districts in Los Angeles, Sacramento, Las Vegas, Oakland, and Cleveland. Their performance has proven a cost-effective means of ensuring capital programs are managed efficiently, effectively, and equitably.

The success of oversight committees depends on many factors, chief among them strong leadership, the backing of the government, and, accurate and timely project performance data and financial reporting. Our office believes the provisions of SB 784 would have assured the members access to that vital data and reporting and ensure the committees' and the bonds success.

Thank you again for your invitation to appear and speak on this important issue. Subject to your questions, this concludes my testimony.