

October 30, 1989

To: SPP
From: CEVH, DA, SAW
Re: State Audit

As per your request, we have prepared this framework for conducting the state audit. We contacted several consulting and auditing firms, officials from state government associations, and several state auditors, and people in New Jersey and other states who have participated in similar exercises.

The government audit should be conceived as an effort by the Florio Administration to save money and improve the management of state government. Unlike some other commissions, it should not be regarded as a process whereby the business community instructs government on how to run like a business. In other words, this is a collaborative process run by the executive branch with input from the business community.

Objectives

The audit should have four objectives:

1. To fulfill Jim Florio's promise to conduct a comprehensive audit and improve the management of state government.
2. To determine verifiable cost savings for Fiscal Years 1990 and 1991. Phase I must be completed by April/May 1990 in time for final negotiations over the FY 91 budget. This will take the form of an extended budget analysis to identify cost savings that can be achieved in the balance of FY 90 and in the FY 91 budget. Money saved in FY 90 and FY 91 can be dedicated to Florio priorities and/ or to deficit reduction.
3. To develop and implement management reforms that will save money and deliver programs more effectively in FY 92 and beyond. Phase II should be completed by July/August 1990 and used in the preparation of the FY 92 budget.
4. To institutionalize better management and accounting procedures and practice in state government. Phase III-- recommendations for improving the capacity of state government to manage programs--should be contained in the final report and implemented during the balance of the governor's term.

The audit process will have several major benchmarks.

Mid-November: Process begins and is coordinated with the budget and departmental reviews. Cost savings identified during the transition will be given to the Commission staff.

December: Government Management Commission is formed and Requests for Proposals to work for the Commission are solicited. The contractor or contractors will be responsible for collecting and organizing information for review by Commission staff and Commission Members. Funds to conduct the audit are raised.

Late January: A Florio Government Management Commission is announced within days of the inauguration. This timing is recommended so that the Commission has sufficient time to begin operations before it is exposed to intense public scrutiny.

April/May: The Commission staff and contractor further develop and refine the list of savings and present them to the Governor in an interim report.

July/August: The Commission makes a final report which recommends additional cost savings and other management improvements for implementation with the Departments and Authorities in the FY 92 budget and beyond. The Commission also recommends procedures and practices that will improve the management and organization of New Jersey state government.

Cost

Without detailed specifications we could not obtain a refined cost estimate, but the audit would require at least \$1 million for purchase of services and would cost much more, including in-kind contributions from government and the private sector.

Structure

We recommend the formulation of a private, non-profit organization with a board of directors. The board can then raise money, pay a staff and contractors to conduct the work of the audit, and use loaned executives and academics.

The board should consist of senior staff from the governor's office, the OMB Director and Treasurer, and "public members" recommended by the Governor. Some states have used legislators on the Commission as well. We do not recommend this, however. Instead we think that key legislators should be kept informed. It is important to develop a champion or champions in the legislature. Senior staff from the governor's office should be assigned to manage the process from beginning to end.

The board of directors should raise money for the effort, review and help select the contractors and review and issue interim and final reports. But it must be made clear to all participants that the audit is managed by the governor's office for the governor. Thus the content, timing, and public discussion of the audit are the responsibility of the governor and his staff. Press relations for the Commission should be handled by the Governor's Press office.

Phase I of the audit--the identification of cost savings-- will be conducted primarily by the contractor, working in conjunction with the departments and the OMB. This is necessary due to the time constraints and due to the need for control of the process.

Phase II--the identification of better management practices and possible government reorganization--will involve the contractor, loaned executives, and Department and Authority managers. In other words, the final report should be a collaborative effort between people responsible for managing the state government and management experts from the public and private sector who will offer suggestions for improvement. The recommendations in the final report should feature ideas from the Departments. It is important that the final report not be viewed as adversarial, but rather as a joint effort of the new Florio team to improve government management.

Phase III--the institutionalization of improved management practices--will be primarily the responsibility of the governor's office and the Treasurer working in conjunction with the Departments and Authorities.

Audit Coverage

The audit process should include all major departments and authorities of state government. We suggest a two-tier approach. Intense scrutiny should be given to major departments and authorities, such as Treasury, DEP, Human Services, Turnpike, and Parkway and others, especially during Phase I. Other departments and authorities should also be reviewed, but fewer resources should be devoted to them.

Implementation of Audit Recommendations

It is especially important to make sure that the findings developed during each phase of the audit can be implemented by the governor, the legislature, and the departments. A major downside risk of this exercise is coming up with a long list of findings that are politically explosive and therefore ultimately ignored by state government.

Several steps must be take to guard against this downside risk.

First, as noted above, the cost savings portion of the audit should be tightly managed by the governor's staff and reviewed for political sensitivity. No recommendations should be released to the public and the legislature without high probability that they can be achieved.

Second, the staff and contractor will be required to submit only verifiable cost savings recommendations. Specifically, the contractor should be required to submit complete documentation for any proposed cost savings. Many Commissions of this sort contain a lot of pie in the sky recommendations that do not hold up under examination.

Third, the staff and contractor must work very closely with OMB, the departments, and the legislature to make sure that identified savings are implemented through the budget process.

Fourth, the Commission should NOT consider revenue increases, user fees or tax reform. While such items must be considered by others on the governor's management team, it is important to draw sharp distinctions between the management review and the overall budget process. This is important in explaining the commission's work to the public and the legislature and it will help keep people focused on their principal mission; namely, to make cost saving recommendations.

Possible Contractors

The contractor or contractors selected to staff the audit should be selected by RFP. As a non-profit, the Commission will not be bound by state procurement regulations, but should follow them in spirit. Several large accounting and management firms would likely bid, along with smaller firms. The RFP should encourage firms to enter into consortia to provide the greatest expertise on government programs in a short period of time. Most of the firms have a set methodology for conducting these exercises. The RFP and subsequent negotiations with the selected firm should be designed to tailor the approach to our needs.

Advantages and Disadvantages

As structured, the audit process offers several benefits for the new Governor. First, it fulfills his campaign promise to look for and find cost savings. Second, "savings" can be converted to support Florio programs or used to reduce the deficit and thus protect other programs from being cut. Having done the audit, Florio sets the stage for a new fiscal policy--one including tax reform--if he so desires. He sends strong signals to line managers that he is serious about government management. At several points, he is publicly associated with management improvement and efficiency. And he involves prominent executives in a good government exercise.

Obviously, problems from conducting the audit will arise if it is handled poorly. It must be carefully orchestrated by the governor's staff. The recommendations must be carefully screened. Interested parties will doubtless find fault with some if not most of the recommendations, no matter how carefully they are reviewed. There are seldom significant savings to be had without political pain. Audits can thus add to the budget burden by creating aggrieved constituencies and legislators who rally against it.

Substantial cost savings must be found so that the exercise is seen to be worthwhile. This creates pressure to exaggerate savings or make politically foolish recommendations and thus create embarrassments down the road.

For all these reasons, it is important not to hype the audit so much that the press expects the entire budget gap will be closed when the findings come in. It should be described as a long-term effort to get control of state government and get the entire government to think about saving money and managing things better. Savings will be found, but the audit is not a substitute for the budget process where choices about spending more or less on a given service must be made.