

STATE AGENCY EFFICIENCY AUDITS



by Daniel Sánchez-Piñol, Ph.D., Andrew Brown, J.D., and Luke Posegate

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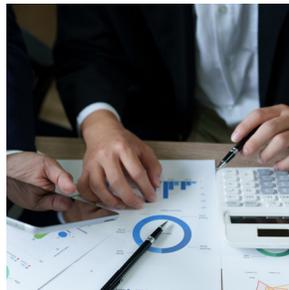


Table of Contents

Executive Summary 3

Texas' Quality of Public Services 3

Efficiency Audits Overview. 4

Definition and Institutional Design. 4

State Auditor. 6

Legislation 6

Theory 6

Literature Review. 7

Evidence of Past Audit Programs in the United States 7

Louisiana Temporary Assistance for Needy Families (TANF) Program Efficiency Audit 7

Texas Temporary Assistance for Needy Families (TANF) Program Efficiency Audit. 8

Detroit Public Schools (DPS) Efficiency Audit 8

Wyoming Statewide Efficiency Audit 8

Kansas Statewide Efficiency Audit 8

Recommendations 8

Conclusion 9

References 10

State Agency Efficiency Audits

Daniel Sánchez-Piñol, Ph.D., Andrew Brown, J.D., and Luke Posegate

Executive Summary

Texas ranks below average compared to other states in the nation in terms of the quality of public services offered. Given that the size of the state budget has expanded significantly over the last two decades, it is pressing to ensure that public resources are used as efficiently and economically as possible. For this reason, we propose that every Texas state agency undergo an efficiency audit from a private, independent third party on a regular basis. In doing so, the Lone Star State will safeguard taxpayers' money from wasteful spending and guarantee the highest quality in the provision of public goods and services.

Texas' Quality of Public Services

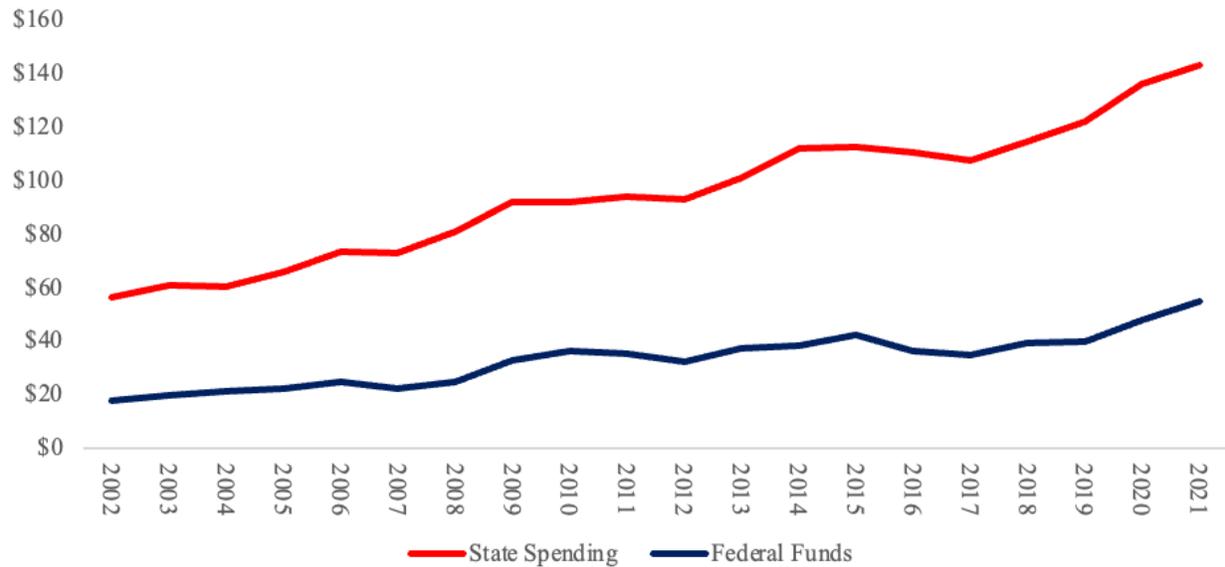
According to the *U.S. News Best State* ranking, Texas occupies the 31st position in public service performance ([U.S. News, 2021](#)). The ranking accounts for the quality and accessibility of services primarily provided by the states, including education, healthcare, infrastructure, and public safety. A similar study by WalletHub considers the total taxes paid per capita and the quality of public services. In this study, Texas ranks 5th in total taxes paid per capita, indicating a low-tax burden on residents, but occupies the 36th position in terms of the overall quality of government services ([Kiernan, 2022](#)). One possible explanation for low service quality could be that public agencies lack the necessary funding due to the relatively low tax burden. However, other states have showed that a superior combination of low-tax and high-quality services is feasible. For example, Florida ranks 2nd in total taxes paid per capita and 22nd in overall quality of services, which means it has both lower taxes and higher quality service than Texas. The top ranked state for overall taxpayer return on investment, New Hampshire, ranks 3rd in total taxes paid per capita and 4th in overall quality of services. Although Texas is in good company when it comes to its low tax burden, it has some ground to make up in the quality of services it provides.

Complicating the state's effort to provide Texans with the best return on their investment is a trend toward increased government spending in recent years. As **Figure 1** shows, Texas state expenditures grew an average of 5% annually over the last two decades. Over the same period, federal funds assigned to Texas have increased by 7%. This upward trend in state spending exceeds inflation plus population growth of 3.6% annually ([Ginn & Sánchez-Piñol, 2022](#)), which creates a stronger case for more robust oversight in allocating public resources. Efficiency audits are a useful tool that lawmakers can deploy to improve the quality of services while maintaining Texas' status as one of the top low-tax states.

Key Points

- An efficiency audit is an independent evaluation of the economy, efficiency, and effectiveness of state agencies, public programs, and related organizations. It assesses how well public organizations are achieving their official goals. The recommendations made by the efficiency audits often help improve performance and reduce wasteful spending, overlapping programs, and corruption.
- Texas ranks below average in terms of the quality of public services despite continued growth in public spending.
- Efficiency audits in Texas are conducted on an ad-hoc basis. Our policy recommendation is to require one at regular intervals for every state agency.

Figure 1
Evolution of Texas' State Spending and Federal Funds (in billions)



Note. Data is from *State Expenditure Report Historical Data Set, 1991-2021*, National Association of State Budget Officers, (https://www.nasbo.org/mainsite/reports-data/historical-data?attachments=&libraryentry=629bc842-583e-49ac-b206-16be92cdf1b4&pageindex=0&pagesize=12&search=&sort=most_recent&viewtype=row).

Efficiency Audits: Overview

Definition and Institutional Design

An efficiency or performance audit is an independent evaluation of the economy, efficiency, and effectiveness of state agencies, public programs, and related organizations (Bawole & Ibrahim, 2016). Economy assessments help determine if an agency or program is cost-minimizing. Efficiency looks to maximize return on investment, and effectiveness considers whether the entity is achieving its desired goals. Efficiency audits differ from other types of audits. While financial and compliance audits assess whether an entity meets reporting and regulatory requirements, efficiency audits measure success against the entity's standards.

Performance audits are undertaken by either the public or the private sector. In the public sector, the Government Accountability Office (GAO) is the supreme audit institution (SAI) for the United States (Government Accountability Office, n.d.). The GAO provides standards for internal controls, financial audits, and other types of

government audits for federal and state auditors. The State Auditor's Office (SAO) is the public auditor for the state of Texas (Texas State Auditor's Office, n.d.).

According to the Texas Government Code, the SAO can conduct financial and efficiency audits directly for any entity receiving state funds (Section 321.013). As described in Figure 2, the SAO is appointed by the Legislative Audit Committee (LAC; Section 321.005)—a six-member oversight committee that consists of the speaker of the House, the lieutenant governor, one member of the Senate appointed by the lieutenant governor, and the chairmen of the Senate Finance Committee, House Appropriations Committee, and the House Ways and Means Committee (Section 321.002). There are no term limits for the state auditor.

As Figure 3 shows, there are currently two ways to initiate an efficiency audit: through the SAO and through legislation.

Figure 2
Legislative Audit Committee Membership Composition

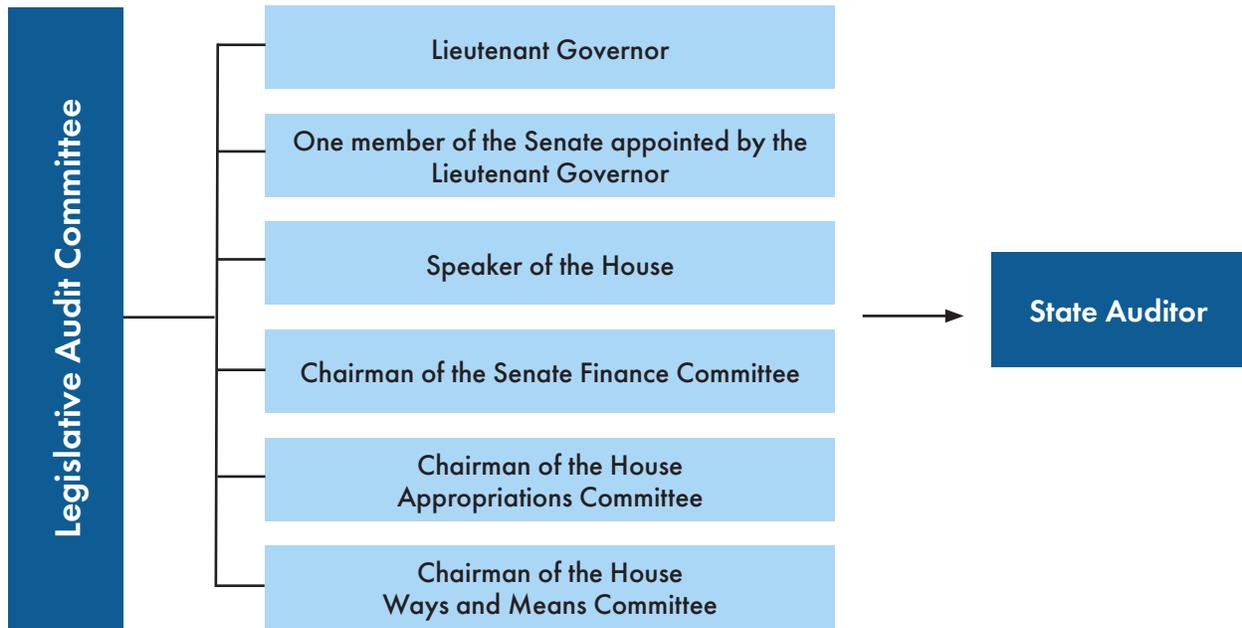
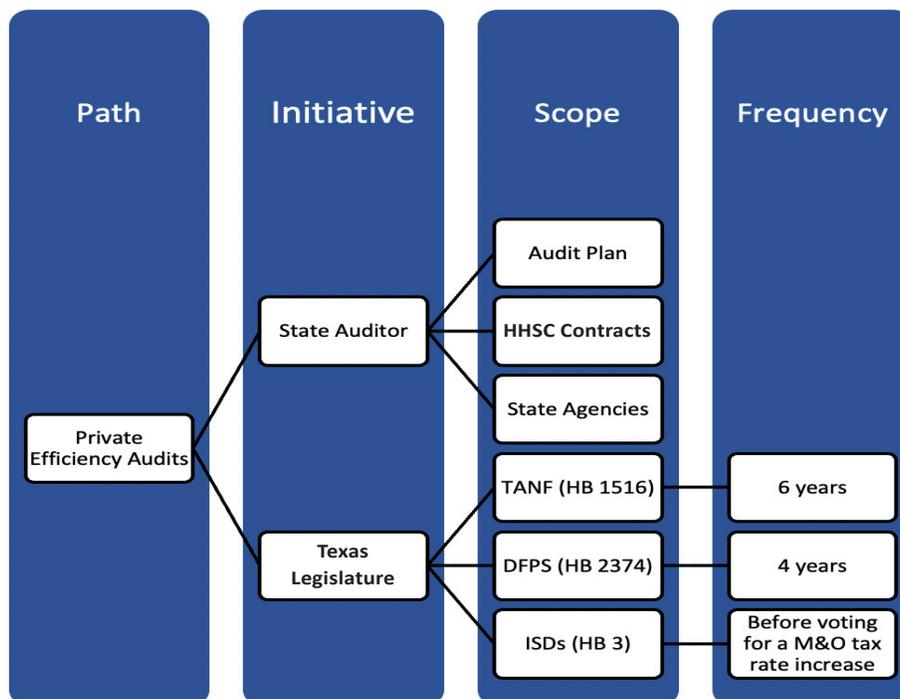
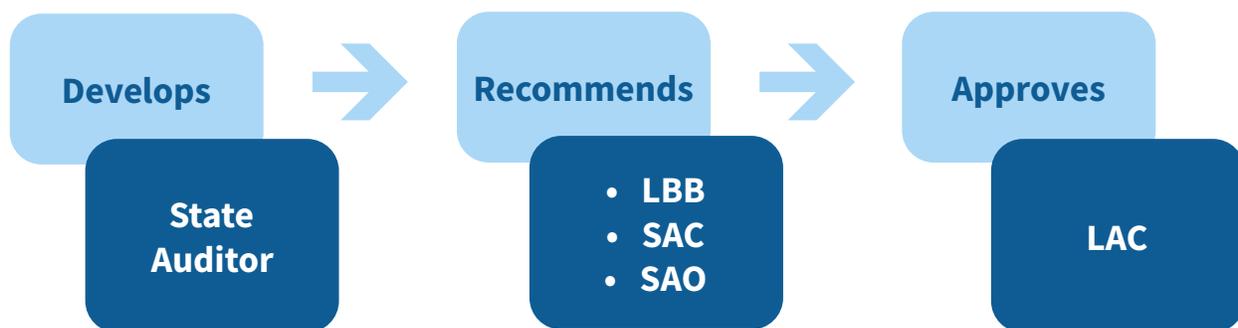


Figure 3
Private Efficiency Audits Initiatives



Note. Information reproduced from Texas Government Code Section 321.013(k) and Section 321.020 (<https://statutes.capitol.texas.gov/Docs/GV/pdf/GV.321.pdf>), House Bill 3 (<https://capitol.texas.gov/tlodocs/86R/billtext/pdf/HB00003F.pdf>), House Bill 2374 (<https://capitol.texas.gov/tlodocs/87R/billtext/pdf/HB02374F.pdf>) and House Bill 1516 (<https://capitol.texas.gov/tlodocs/87R/billtext/pdf/HB01516F.pdf>).

Figure 4
Audit Plan Flowchart



Note. Information reproduced from Texas Government Code Section 321.013 (<https://statutes.capitol.texas.gov/Docs/GV/pdf/GV.321.pdf>).

State Auditor

One of the channels to start an efficiency audit is through the audit plan. The SAO is required to submit an audit plan annually to the LAC for its approval. The plan contains all the audits (including efficiency audits), reviews, and investigations outlined for that year. As presented in **Figure 4**, the state auditor can consider recommendations from the Legislative Budget Board (LBB), Sunset Advisory Commission (SAC), and State Auditor's Office when devising the plan ([Section 321.013](#)). It is important to note that the development of the audit plan is entirely within the discretion of the state auditor, so there is no guarantee that an efficiency audit will be conducted on a particular agency with any regularity.

The SAO also has the prerogative to hire an independent private auditor to conduct an efficiency audit for contracts that exceed \$100 million annually for the Health and Human Services Commission (HHSC; [Section 321.013\(k\)](#)). Moreover, the SAO can delegate to state agencies to contract a private audit directly through a competitive selection process ([Section 321.020](#)). In both cases, the SAO or the state agency must award the contract to the firm offering the best value for the state considering the services provided. In addition to price, a number of factors may be considered when determining which firm provides the best value. These factors include the bidder's financial resources and ability to perform the contract, the bidder's previous and existing compliance with laws relating to the contract or service, the bidder's experience, and the quality and availability of the goods or contractual services ([Texas Government Code Section 2156.007](#)).

Legislation

The second channel for initiating an efficiency audit is through legislation enacted by the Texas Legislature. In recent years, the Legislature has taken a leading role in requiring efficiency audits of certain public agencies. The 87th Legislature passed House Bill 2374 ([2021](#)), requiring a regular efficiency audit of the Department of Family and Protective Services (DFPS), and House Bill 1516 ([2021](#)), requiring an efficiency audit of the state's implementation and administration of the TANF program. Moreover, in 2019, the 86th Legislature passed House Bill 3 ([2019, pp. 1–3](#)), which required local school districts (ISDs) to conduct an efficiency audit before holding a vote to increase the district's maintenance and operations tax rate. These examples illustrate a key advantage of initiating efficiency audits via the legislative channel as opposed to through the State Auditor's Office, namely that legislative action creates a legal requirement subjecting specific governmental entities to regular oversight.

Theory

Efficiency audits are a tool to potentially solve the principal-agent problem in economics ([Blume & Voigt, 2011](#)). The public (principal) delegates the management of public resources to the government or state (agent) for the provision of public goods. For the principal, it is costly to observe or monitor the agent's actions. Due to asymmetric information or misaligned incentives, the agent might deviate from acting in the principal's best interest. The difference between the quantity of public good the principal would have chosen and what the agent actually chose is called agency cost. In this sense, an efficiency audit is a mechanism to mitigate agency costs and ensure that the agent acts in the principal's

best interest. Pragmatically, the agency cost often manifests itself in excessive government expenditure, the presence of corruption, and a reduction in labor and total productivity ([Blume & Voigt, 2011](#)). That is why other objectives of efficiency audits include cost minimization, elimination of unproductive or overlapping programs, and improved accountability ([Bawole & Ibrahim, 2016](#)).

Literature Review

Most of the academic literature available has studied efficiency audits conducted by SAIs. Research has shown that efficiency audits generally lead to positive outcomes. Inside the United States, for example, Thompson and St. John ([2019](#)) report that performance audits have helped reduce wasteful expenditures in school districts. In addition, Schelker ([2008](#)) finds that efficiency audits improve government performance ratings measured by the Government Performance Project. The rating covers five areas: financial management, capital management, human resources management, managing for results, and information technology management. The main mechanism for efficiency audits to produce positive outcomes was avoiding corruption and identifying waste and misappropriation of public funds. Other studies outside the United States reached similar conclusions ([Morin, 2014](#); [Raudla et al., 2016](#); [Yetano et al., 2019](#)).

However, these positive results depend on the institutional design of efficiency audits. Not all audits are equally effective at increasing the efficiency of government performance. Elected auditors outperform appointed auditors in this regard ([Schelker, 2008](#)). Similarly, the implementation of auditor recommendations depends on the entity tasked with overseeing the follow-up process. Performance audits, therefore, have different effects depending on who is doing the oversight—a court, legislature, or independent public agency—and whether those doing the oversight have the power to punish or reward the auditees ([Torres et al., 2019](#); [Blume & Voigt, 2011](#); [Raudla et al., 2016](#); [Morin, 2014](#)). Other important factors affecting an efficiency audit's success are the quality of the audit ([Johnsen et al., 2001](#)), its perceived usefulness ([Yetano et al., 2019](#)), and the auditees' willingness to cooperate ([de Lancer Julnes, 2006](#)).

As mentioned before, the private sector can also perform efficiency audits. This alternative can potentially avoid some of the shortcomings that are generally attributed to the public sector, such as regulatory capture ([Stigler, 1971](#)), rent-seeking ([Tullock, 1967](#); [Niskanen, 1968](#)), lack of contestability ([Hayek, 2016](#)), and corruption ([Johnson et](#)

[al., 2011](#)). Consequently, a private auditor can bring an extra layer of independence, transparency, and accountability.

Evidence of Past Audit Programs in the United States

Efficiency audits of state government programs are nothing new in the United States. A number of states and municipalities have undergone audits that aim to improve the efficiency and quality of public services. This section will briefly summarize the results of a few notable examples of audits that have improved overall service quality and yielded millions of dollars per year in savings.

Louisiana Temporary Assistance for Needy Families (TANF) Program Efficiency Audit

The Temporary Assistance for Needy Families program (TANF) is a federal program that allocates \$16.5 billion annually across all states to fight child poverty ([Louisiana Legislative Auditor, 2021, p. 1](#)). It aims to assist low-income families with children to become economically self-sufficient. TANF assistance includes cash transfers, vouchers, and job training. It also promotes marriage and seeks to prevent out-of-wedlock pregnancies ([Louisiana Legislative Auditor, 2021, p. 1](#)).

In 2021, the Louisiana Legislative Auditor's Office conducted an efficiency audit. The Department of Children and Family Services (DCFS) administers TANF's funds in that state. The efficiency audit identified major problems and recommended the DCFS make the following changes:

1. To improve fund management, determine how administrative costs are distributed between contracts and subcontracts ([Louisiana Legislative Auditor, 2021, p. 11](#)).
2. Keep track of outcome-based measures to assess whether the TANF's goals are being met ([p. 20](#)).
3. Construct an outcome measure to evaluate the reduction of out-of-wedlock pregnancies, given that Louisiana ranked 2nd highest for out-of-wedlock pregnancies between 2014 and 2019 ([p. 20](#)).
4. Expand cash assistance programs to promote the work participation rate, which was the lowest in the nation at 3.5% in 2020 ([p. 20](#)).

The DCFS accepted and agreed to implement all the recommendations ([Louisiana Legislative Auditor, 2021, pp. 11, 20](#)). As a result of the efficiency audit, the DCFS will enhance its

We recommend passing legislation requiring all state agencies to be assessed regularly by a private, independent efficiency audit. As a result, the State Auditor or the Texas Legislature would no longer have to carry out this process.

monitoring, oversight, and execution capabilities to improve its outcomes and meet all the TANF's goals.

Texas Temporary Assistance for Needy Families (TANF) Program Efficiency Audit

After the passing of HB 1516 (2021), the SAO selected Public Consulting Group (PCG) to conduct an efficiency audit for Texas' TANF program in 2022. The main finding of the audit was a duplication of services for the Alternatives to Abortion (A2A) program. From 2018 to 2021, A2A's total spending from TANF's funds was \$11.2 million and a cost per user of nearly \$300 (Public Consulting Group, 2022, p. 39). In 2021, total expenditure from all sources for A2A was \$41 million, representing a cost per client of \$322 (p. 74). The audit suggests that the services currently provided by A2A could potentially be absorbed by the Nurse Family Partnership Program, the Early Childhood Intervention program (ECI) and the Texas Workforce Commission (p. 36). Moreover, PCG reports a significant risk of misusing TANF funds given A2A's payment model (p. 73). As a result, funds might be directed to ineligible persons and services. Another key finding is the lack of resources assigned to TANF's goal of forming and maintaining two-parent families, which only received 1% of the total spending (p. 5). The rest of TANF's purposes received more than 10% of the total expenditure (p. 5). Finally, PCG indicated that no single entity provides training, monitoring, and strategic vision for Texas' TANF program at the state level and within the agencies. According to PCG, this lack of oversight has led to multiple errors when spending TANF funds (p. 34).

Detroit Public Schools (DPS) Efficiency Audit

In 2009, Alvarez & Marsal, a private professional services consulting firm, conducted an efficiency audit of Detroit Public Schools (DPS). The auditors developed and

implemented a five-year plan to eliminate a \$305 million deficit by streamlining departments, privatizing business support services, and improving internal budget processes (Alvarez & Marsal, n.d., p. 1). The efficiency audit yielded \$53 million in annual savings, and by 2013, the district's High Risk classification was removed by the Michigan Department of Education due to financial and academic improvements (CBS Interactive, 2013).

Wyoming Statewide Efficiency Audit

In 2018 the state of Wyoming performed a statewide audit that cost \$1.8 million (Coulter, 2020). The state has already saved \$6.2 million in cost savings and avoidance (Wyoming Spending and Government Efficiency Commission, 2019a, p. 2), with another \$85 million in potential savings for the 2021–2022 biennium (Wyoming Spending and Government Efficiency Commission, 2019b, p. 79). If all these potential savings are realized, the benefit-cost ratio would be 50.7, meaning that the efficiency audit would provide the state of Wyoming a benefit nearly 51 times greater than the cost incurred.

Kansas Statewide Efficiency Audit

In 2016, an efficiency audit in Kansas suggested 105 recommendations yielding an estimate of over \$2 billion in savings over the next five years (Alvarez & Marsal, 2016, p. 1). The most significant cuts were proposed in education, revenue collection, and Medicaid. According to the Kansas Legislative Division of Post Audit (KSLPA), 43 of the 105 recommendations have been implemented by state agencies, with 5 more in progress. The progress report estimated cost savings of nearly \$50 million for 2019 (Stowe, 2019).

Recommendations

As shown in Figure 3, efficiency audits in Texas can be initiated through the SAO or legislation. Both channels are used on an ad-hoc basis; that is, efficiency audits are targeted for a specific state program like TANF or agency like DFPS. We recommend passing legislation requiring all state agencies to be assessed regularly by a private, independent efficiency audit. As a result, the SAO or the Texas Legislature would no longer have to carry out this process. All state agencies will be automatically subjected to efficiency audits regularly. Ideally, the bill should contain the following:

- 1. Enforcing mechanisms:** Recommendations should be binding. The SAO can require compliance of any recommendations made by the independent, private auditor that the state agency has not fully addressed.

2. **Frequency:** Efficiency audits should be conducted on a regular basis. Previous efficiency audit legislation has required the audit to be conducted every four years in an even-numbered year and published immediately preceding a legislative session. This timing allows lawmakers to consult the most up-to-date evaluation of agency performance as they develop the state's biennial budget.
3. **Funding:** Efficiency audit funding would be budget neutral. The efficiency audit should be funded using the resources appropriated by agencies for their regular financial audit and should cover any additional costs to the State Auditor's Office. The year that an efficiency audit is required, it would replace the agency's required financial audit.
4. **Publication, Access, and Diffusion:** The publication of the findings and recommendations of the efficiency audit should be made available to the public before the Legislature convenes. The audit findings should be used as input for every policymaker and complement other legislative activities like the budget approval and sunset process ([Sunset Advisory Commission, 2021](#)).

Conclusion

Private, independent, third-party efficiency audits have proven to be an effective tool to improve the performance of state agencies. Benefits include cost minimization, better performance, enhanced transparency, and more robust oversight. The 88th Legislature should build on this foundation by enacting legislation that subjects all state agencies to regular efficiency audits and thereby safeguards the proper use of public resources. ★

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