

Date of Hearing: July 5, 2023

ASSEMBLY COMMITTEE ON ELECTIONS

Gail Pellerin, Chair

SB 569 (Glazer) – As Amended June 27, 2023

SENATE VOTE: (vote not relevant)

SUBJECT: Political Reform Act of 1974: audits.

SUMMARY: Transfers responsibility for conducting audits of lobbying disclosure reports and statements from the Franchise Tax Board (FTB) to the Fair Political Practices Commission (FPPC). Specifically, **this bill:**

- 1) Repeals a requirement that the FTB make audits and field investigations with respect to reports and statements filed with the Secretary of State related to lobbying disclosure laws, beginning with lobbying firms and lobbyist employers that are selected for audits after 2023. Requires the FPPC to make such audits and field investigations beginning with lobbying firms and lobbyist employers that are selected for audits in February 2025.
- 2) Requires that lobbying firms and lobbyist employers with less than \$1 in payments or contributions be excluded from being selected for an audit.
- 3) Requires the FPPC to do all of the following:
 - a) Publicly post any audit conducted by the FPPC on its website for at least 10 years following the conclusion of the audit;
 - b) Report annually to the Legislature on the number and type of audits completed by the FPPC; and,
 - c) Adopt regulations or policies to ensure operational independence of audit personnel from enforcement operations under the Political Reform Act (PRA).
- 4) Makes technical and conforming changes.

EXISTING LAW:

- 1) Creates the FPPC, and makes it responsible for the impartial, effective administration and implementation of the PRA. (Government Code §§83100, 83111)
- 2) Requires audits and investigations to be made with respect to reports and statements required by the PRA of the following:
 - a) Candidates for office, and their controlled committees, as follows:
 - i) All candidates for statewide office, supreme court, court of appeal, and Board of Equalization (BOE) that raised or spent \$25,000 or more in a primary or general election, as specified;

- ii) 10% of statewide candidates who raised or spent less than \$25,000 in a primary or general election, selected at random, as specified;
 - iii) All candidates in 25% of Senate districts, Assembly districts, and superior court offices, selected at random, who raised or spent \$15,000 or more in a primary or general election, as specified; and,
 - iv) All candidates for the Legislature in a special primary or special runoff election who raised or spent \$15,000 or more in the election, as specified;
- b) All committees primarily supporting or opposing a candidate selected for audit and that spent more than \$10,000 on the candidate's race, except as specified;
 - c) All committees primarily supporting or opposing a state ballot measure that spent more than \$10,000 supporting or opposing that measure, as specified;
 - d) State general purpose committees, except as specified, that raised or spent more than \$10,000 as follows:
 - i) All such committees that have not previously been audited, or that were audited and where the FPPC determined based on the audit that the committee was not in substantial compliance with the PRA; and,
 - ii) 25% of such committees that were previously audited and where the FPPC determined based on the audit that the committee *was* in substantial compliance with the PRA, selected at random;
 - e) Local candidates, their controlled committees, and candidates for the Board of Administration of the Public Employees' Retirement System as determined pursuant to regulations adopted by the FPPC; and,
 - f) 25% of lobbying firms and lobbyist employers, selected at random. Any lobbyist employed by a firm or employer that is selected for an audit is audited as part of the firm's or employer's audit. (Government Code §90001)
- 3) Requires the FTB to perform the audits and field investigations detailed above, except in the case of audits and investigations of candidates for Controller and member of the BOE, and committees primarily supporting or opposing those candidates, which are performed by the FPPC instead. (Government Code §§90000, 90006)
 - 4) Permits the FTB and the FPPC, in addition to the audits and investigations required by the PRA, to make investigations and audits of any other reports and statements required by the PRA. (Government Code §90003)
 - 5) Requires a person who acts as a placement agent, as defined, in connection with a potential investment made by a state public retirement system, to register as a lobbyist. (Government Code §§7513.8, 7513.86, 82002, 82039, 82047.3)

FISCAL EFFECT: Unknown. State-mandated local program; contains a crimes and infractions disclaimer.

COMMENTS:

1) **New Bill:** This bill recently was amended at the request of the author to delete its prior contents and add the current provisions. As a result, prior votes and analyses are not relevant. The current version of this bill proposes policy changes that have not been heard in an Assembly or Senate policy committee during this legislative session.

2) **Purpose of the Bill:** According to the author:

Earlier this year, the Senate Committee on Elections and Constitutional Amendments held an oversight hearing about the lack of lobbying audits performed by the Franchise Tax Board. The hearing shed light into the challenges and provided potential solutions to this ongoing problem by bringing together the stakeholders involved in the auditing process. It became apparent that the number of audits performed were woefully under what is required pursuant to current law.

This bill seeks to transfer the duties of performing lobbying audits from the Franchise Tax Board to the Fair Political Practices Commission and creates a way for both entities to meet their audit requirements. For a system of transparency to work, the required tasks of each governmental bodies need to be functioning at full efficiency. When one key aspect of the transparency is removed, it limits and affects the rest of the well-being of our political reform system.

3) **Political Reform Act Audits:** In 1974, California voters passed an initiative, Proposition 9, that created the FPPC and codified significant restrictions and prohibitions on candidates, officeholders, and lobbyists. That initiative is commonly known as the PRA.

As part of its regulation of campaigns and lobbying, the PRA requires candidates, political committees, and lobbyists to prepare periodic reports disclosing their activities. These statements and reports are submitted to specified government agencies, where they are made available to the public. Additionally, the PRA requires these statements and reports to be audited, typically by the FTB.

A report issued by the FPPC in February 1979, titled *California's Fair Political Practices Commission: The First Four Years*, explains that the PRA split enforcement and investigatory responsibilities among multiple agencies in an effort to ensure impartial and effective enforcement. The report states, "Mindful of the lessons of Watergate, the authors of the Political Reform Act assigned enforcement of the law to more than one agency, creating a system of 'checks and balances' to offset any potential political favoritism or unwillingness to take action."

This idea of a system of "checks and balances" aligns with a provision in the PRA that assigns certain audits to an entity other than the FTB. Specifically, audits related to candidates for Controller and the BOE, as well as committees supporting or opposing those candidates, are entrusted to the FPPC. This arrangement protects against an appearance that

the Controller and the Chair of the BOE, who are members of the FTB, could improperly seek to influence those audits.

When the PRA was enacted, it established two types of audits: mandatory audits and discretionary audits. The mandatory audits required by the PRA included audits of all lobbyists, all candidates who received more than 15% of the vote in a general or special election, all candidates who spent more than \$25,000 and committees supporting such candidates, and other committees that spent more than \$10,000 in a calendar year. In addition to these mandatory audits, the PRA permitted the FTB and the FPPC to conduct discretionary audits.

Four years after the PRA's enactment, AB 3667 (McVittie), Chapter 1411, Statutes of 1978, created a third type of audits: random audits. These replaced mandatory audits for certain candidates and committees, and for lobbyists under certain situations. Unlike mandatory audits that require auditing all entities meeting certain criteria, random audits instead require auditing a specified percentage of entities that meet the selection criteria. The FPPC determines on a random basis the persons or political districts that must be audited.

AB 3667 was sponsored by the FPPC in response to an audit report prepared by Arthur Anderson & Co. and released by the Auditor General in August 1977. That report, titled *Efficiencies and Economies of the Administration of the Political Reform Act of 1974*, concluded that requiring the FTB to audit 100% of entities meeting the mandatory selection criteria "results in an unnecessarily high level of auditing" and that "[i]t is not necessary to audit every candidate, lobbyist, and committee to ensure compliance with the [PRA]." In a cover letter to the audit report, the Chair of the Joint Legislative Audit Committee indicated that the FTB's costs for PRA audits alone exceeded \$2.5 million, even though the proponents had estimated that the total costs of the PRA would be approximately \$1 million. Legislative records related to AB 3667 indicated that the bill was expected to save up to \$1 million in FTB auditing costs per year.

- 4) **Senate Oversight Hearing:** According to the author, this bill was introduced in response to a March 7, 2023, oversight hearing by the Senate Elections & Constitutional Amendments Committee on the subject: *Status of Lobbying Audits—Franchise Tax Board*. Background materials prepared by the Committee for that hearing reveal that the FTB completed just four audits of lobbying firms and lobbyist employers for the two most recent legislative sessions for which the auditing period has ended—none for the 2017-18 session, and two lobbying firms and two lobbyist employers for the 2019-20 session. Based on the number of registered lobbying firms and lobbyist employers, the PRA required that more than 300 lobbying audits be conducted for each of those two legislative sessions.

At the hearing, an FTB representative testified that it had never received sufficient resources to conduct all PRA audits since the PRA was enacted in 1974. The representative further testified that FTB staff is responsible for PRA audits for 17 different workloads, and that in the last six fiscal years, FTB audits for those workloads generally had approached 10-50% of the levels required by the PRA. For lobbying audits, however, the FTB completed 3% or less of the required audits during that period.

- 5) **FTB Budget and Positions for PRA Audits:** At the oversight hearing described above, FTB staff indicated that the unit responsible for completing all of the PRA audits assigned to the

FTB has 13 authorized positions—nine of whom conduct audits (the remaining staff serve in support roles). The Governor similarly proposed 13 authorized positions for that unit in the 2023-24 budget year, and the adopted version of the state budget did not alter the proposed budget for that unit.

Based on a review of historical budget documents, it appears that the number of authorized positions in the Political Reform Audit unit of the FTB has not changed since the unit lost two authorized positions in the 2009-10 budget year, even though the number of audits required by the PRA has increased as a result of policy changes described in more detail below. For each budget year between 1999-2000 and 2008-09, the Political Reform Audit unit of the FTB had 15 authorized positions.

- 6) **Previous Legislation and Lobbying Audit Workloads:** AB 1743 (Hernandez), Chapter 668, Statutes of 2010, requires a person who acts as a placement agent in connection with a potential investment made by a state public retirement system to register as a lobbyist pursuant to the PRA, among other provisions. AB 1743 took effect on January 1, 2011. The enactment of AB 1743 significantly increased the number of lobbying firms and lobbyist employers registered in California.

Under the PRA, lobbying registration is tied to two-year legislative sessions. In February of each odd-numbered year, the FPPC selects the lobbyist employers and lobbying firms to be audited for the preceding two-year session. For the 2009-10 Legislative Session (the last session before AB 1743 went into effect), 58 lobbyist employers and 91 lobbying firms were selected for audit, totaling 139 required lobbying audits. However, after AB 1743 went into effect, the number of lobbying audits required by the PRA increased substantially. For the 2011-12 Session, 238 lobbying audits were required (136 lobbyist employers and 102 lobbying firms), and for the 2013-14 Session, 304 lobbying audits were required (183 lobbyist employers and 121 lobbying firms). Since the 2013-14 Session, the required number of lobbying audits has remained steady at around 310 audits per two-year session. Since the implementation of AB 1743, the number of lobbying audits required by the PRA has more than doubled, with a corresponding increase in the FTB's lobbying audit workload.

- 7) **Activity Thresholds for Audits:** Currently, the PRA requires random audits of lobbying firms and lobbyist employers that employ one or more lobbyists, regardless of their level of activity. On the other hand, candidates and campaign committees generally are subject to audits only if they meet specified monetary thresholds for contributions received or expenditures made. (The only exception is for statewide candidates. The PRA requires all such candidates that raised or spent \$25,000 or more to be audited, and requires random audits of 10% of the candidates that raised and spent less than \$25,000.)

The monetary thresholds that determine whether a campaign or committee is subject to audit selection have not been updated since they were first established in 1974 (when the PRA was adopted) and 1978 (when AB 3667 updated the auditing rules and established random audits). As a result, when accounting for inflation, the amount of campaign activity that triggers audits now represents only 16-22% of the activity level when those thresholds were initially set.

- 8) **Prior Effort to Shift Lobbying Audits:** The Governor's May revision for the proposed state budget for the 2021-22 fiscal year included a proposal, similar to this bill, to redirect the

responsibility for performing lobbying audits and investigations from the FTB to the FPPC. At the time, the FPPC requested five positions and \$637,000 in funding from the general fund in 2021-22, and \$602,000 annually thereafter, to handle the required audits and investigations. The FPPC also sought trailer bill language to make necessary statutory changes for that transfer of responsibility. However, the relevant budget subcommittees in the Assembly and the Senate both rejected that request. Instead, the subcommittees voted to allocate the proposed funding to the FTB so that they could continue to conduct those audits. The final version of the budget for the 2021-22 fiscal year, however, did not include additional funding for the FTB, nor did it include the funding and authority for the FPPC to take over the responsibility for lobbying audits and investigations.

- 9) **PRA Audit Options:** By helping to uncover violations of the PRA, audits are a crucial tool for enforcing the state's laws regulating campaign spending and lobbying. Furthermore, audits can encourage compliance with the law, as individuals may be more likely to self-regulate if they know that they may be subject to an audit. Those goals can be undermined, however, if audits are rarely conducted or completed.

As detailed above, campaign and lobbying audits are not being conducted at the levels contemplated in the PRA. While it appears that lobbying audits are being conducted at a lower level than most other audit workloads, the FTB testified that it has not been able to approach the required level of auditing in *any* of the PRA audit workloads. Notwithstanding the author's concern that the low level of lobbying audits could undermine the state's political reform laws, it is unclear whether the piecemeal approach proposed by this bill is the most effective way to address that problem.

Based on information provided by the author and presented at the oversight hearing discussed above, and on research by committee staff, it appears that the PRA auditing program has been under-resourced for a large part the time that the PRA has been in effect. As described in more detail above, the PRA's auditing requirements were adjusted in a cost-saving effort just four years after the PRA was adopted after an independent assessment determined that the number of required audits could be reduced without harming the goals of the law.

Given that resource constraints have been a major reason why PRA audits have not been conducted at levels envisioned in existing law, the state likely will need to devote additional resources to conduct all the required audits. This bill, by itself, does not provide any additional resources for PRA auditing. Instead, this bill proposes shifting a portion of the PRA auditing workload from a state board (the FTB) to a state commission (the FPPC). Unless the FPPC redirects existing resources for those audits, the ability for the FPPC to complete the required lobbying audits will depend on future budget actions. At the oversight hearing described above, a representative from the FPPC testified that it would need additional resources to absorb that workload. Subsequently, FPPC staff indicated that it would need nine additional positions to conduct lobbying audits as envisioned by this bill. If the state authorized nine additional positions for PRA audits, that would represent a nearly 70% increase in the total number of authorized positions for that purpose.

If the state is willing to devote additional resources for PRA audits, those resources should allow a larger portion of the audits to be completed, regardless of whether any of the audit workload is shifted. On the other hand, if the state is unwilling to devote additional resources

to PRA audits, then shifting some of the workload from the FTB to the FPPC would be unlikely to have a significant effect on the portion of required PRA audits being completed.

On the other hand, shifting lobbying audits to the FPPC could have unintended consequences, regardless of whether the state provides additional resources for those audits. If the necessary resources are provided, and the FPPC completes 100% of the required lobbying audits while the FTB fails to complete its remaining PRA audit workload, this bill effectively would prioritize lobbying audits over campaign audits. If resources are not provided, then the total number of lobbying audits completed may actually decline, unless the FPPC redirects resources that it currently uses for its other responsibilities.

In addition or as an alternative to allocating additional resources, there are several policy changes that the state could consider to address the lack of compliance with the PRA's auditing requirements:

- (1) Consider adjusting the percentage of entities subject to random audits.
- (2) Reevaluate mandatory audit requirements and consider making those entities subject to random audits instead.
- (3) Consider adjusting monetary thresholds for audit selection to account for inflation.
- (4) Reconsider the policy of requiring placement agents to register as lobbyists and instead, regulate placement agents under a system that is better tailored to their activity, thereby reducing the number of entities subject to auditing.
- (5) Consider providing statutory direction about the PRA audits that should be prioritized if auditing resources are insufficient to complete all required audits.
- (6) Conduct a comprehensive evaluation of the PRA's auditing requirements to determine whether broader changes are justified.

This bill proposes one policy change that may have a moderate impact on PRA auditing workloads. Specifically, this bill proposes to exclude lobbying firms and lobbyist employers with less than \$1 in payments or contributions from being selected for an audit. Placement agents—and the firms and employers that they work for—often do not have reportable payments or contributions that must be reported under the state's lobbying laws, in part because those laws are not tailored to the regulation of placement agents.

In a sample of 50 disclosure reports filed by placement agents, the FPPC found that 45% did not have any reportable payments. Moreover, 70% of the reports had less than \$500 in reportable payments. If these figures accurately reflect the disclosure reports of placement agents as a whole, enacting this bill could potentially reduce the two-year lobbying audit workload by approximately 25%. However, without additional policy changes or resources, this bill's provisions are unlikely to have a substantial impact on the completion rate of required PRA audits.

- 10) **FPPC Audit Division:** In late 2021, the FPPC created an Audits and Assistance Division, with the responsibility for conducting mandatory and discretionary audits, and for selecting

local candidates, controlled committees, and jurisdictions for audit by the FTB. Prior to the creation of that new division, the Audits and Assistance staff was housed within the FPPC's Enforcement Division.

According to FPPC staff, the Audit Division was created, in part, to allay concerns that having audit staff housed within the Enforcement Division could interfere with the independence of audits performed by the FPPC. This bill requires the FPPC to adopt regulations or policies to ensure the operational independence of its audit staff from enforcement operations.

11) Arguments in Opposition: In opposition to this bill, the Institute of Governmental Advocates (IGA) writes:

[T]he PRA as originally enacted divided various responsibilities...to existing governmental agencies, including the Secretary of State and the Franchise Tax Board, while also creating a new agency, the Fair Political Practices Commission. IGA believes that this division of responsibility was sensible at the time and remains sensible today.

SB 569 appears to stem from a concern that FTB has not completed random audits of lobbying firms and lobbyist employers in recent years. Assuming that is true, we do not know if that is Covid-related, staffing related, or related to an excessive number of "mandatory" audits. What we do know is that over the past decade, FTB audits have shown that lobbying firms and lobbyist employers are, in fact, complying with the disclosure obligations of the PRA.

IGA supports the existing audit program and believes that the staffing issues faced by the FTB that may have caused the perceived backlog apply to all persons, entities, and committees subject to mandatory or random audit, not just lobbyists and lobbying firms. Thus, the solution is not to transfer this duty to the FPPC, create a new division in the FPPC, and fund the NEW staffing needed, but rather to simply fund the FTB's existing program.

12) Political Reform Act Amendments: Amendments to the PRA that are not submitted to the voters, such as those contained in this bill, must further the purposes of the initiative and require a two-thirds vote of both houses of the Legislature.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

Institute of Governmental Advocates

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