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# Implementation of State Auditor's Recommendations

Audits Released in January 2002  
Through December 2003

*Special Report to  
Assembly and Senate  
Standing/Policy Committees*

February 2004  
Report No. 2004-406

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# CALIFORNIA STATE AUDITOR

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February 25, 2004

2004-406

The Governor of California  
Members of the Legislature  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its special report for the legislative standing/policy committees, which summarizes audits and investigations we issued during the previous two years. The report includes the major findings and recommendations, along with the corrective actions auditees reportedly have taken to implement our recommendations. This special report also includes an appendix that compiles recommendations that warrant legislative consideration and an appendix that summarizes monetary benefits auditees could realize if they implement our recommendations.

This information is also available in nine special reports specifically tailored for each Assembly and Senate budget subcommittee. These nine special reports are available on our Web site at [www.bsa.ca.gov/bsa/reports/subcom2004-budget.html](http://www.bsa.ca.gov/bsa/reports/subcom2004-budget.html). Finally, we notify auditees of the release of these special reports.

Our audit efforts bring the greatest returns when the auditee acts upon our findings and recommendations. This report is one vehicle to ensure that the State's policy makers and managers are aware of the status of corrective action agencies and departments report they have taken. Further, we believe the State's budget process is a good opportunity for the Legislature to explore these issues and, to the extent necessary, reinforce the need for corrective action.

Respectfully Submitted,

ELAINE M. HOWLE  
State Auditor

# TABLE OF CONTENTS

---

## ***General Policy Areas of the Assembly and Senate***

---

<i>Introduction</i>	1
---------------------	---

---

### *Aging and Long-Term Care*

---

<b>Report Number 2002-120, California Veterans Board:</b> <i>Without a Clear Understanding of the Extent of Its Authority, the Board Has Not Created Sufficient Policies Nor Provided Effective Oversight to the Department of Veterans Affairs</i>	3
--	---

### *Agriculture and Water Resources*

---

<b>Report Number 2000-016, Water Replenishment District of Southern California:</b> <i>Although the District Has Eliminated Excessive Water Rates, It Has Depleted Its Reserve Funds and Needs to Further Improve Its Administrative Practices</i>	9
--	---

<b>Report Number 2001-017, Department of Industrial Relations:</b> <i>Its Process for Verifying the Status of Licenses Issued to Farm Labor Contractors Is Operational but Needs Some Improvement</i>	25
---	----

<b>Report Number 2002-009, California Energy Markets:</b> <i>The State's Position Has Improved, Due to Efforts by the Department of Water Resources and Other Factors, but Cost Issues and Legal Challenges Continue</i>	29
---	----

<b>Report Number 2003-102, Water Quality Control Boards:</b> <i>Could Improve Their Administration of Water Quality Improvement Projects Funded by Enforcement Actions</i>	39
---	----

### *Appropriations*

---

<b>Report Number 2001-117, Superior Courts:</b> <i>The Courts Are Moving Toward a More Unified Administration; However, Diverse Service, Collection, and Accounting Systems Impede the Accurate Estimation and Equitable Distribution of Undesignated Fee Revenue</i>	45
---	----

<b>Report Number 2001-110, Vacant Positions:</b> <i>Departments Have Circumvented the Abolishment of Vacant Positions, and the State Needs to Continue Its Efforts to Control Vacancies</i>	49
---	----

<b>Report Number 2002-124, Franchise Tax Board:</b> <i>Its Performance Measures Are Insufficient to Justify Requests for New Audit or Collection Program Staff</i>	57
<b>Report Number 2002-123.2, Federal Funds:</b> <i>The State of California Takes Advantage of Available Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource</i>	67
<b>Report Number 2003-106, State Mandates:</b> <i>The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process</i>	75
<b>Report Number 2003-107, California Department of Education:</b> <i>The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them</i>	85

#### Business and Professions and Governmental Organization

<b>Report Number 2001-111.2, California National Guard:</b> <i>To Better Respond to State Emergencies and Disasters, It Can Improve Its Aviation Maintenance and Its Processes of Preparing for and Assessing State Missions</i>	99
<b>Report Number 2001-128, Enterprise Licensing Agreement:</b> <i>The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars</i>	107
<b>Report Number I2002-1, Contractors State License Board:</b> <i>Investigations of Improper Activities by State Employees (Allegation I2000-753)</i>	115
<b>Report Number 2002-107, Office of Criminal Justice Planning:</b> <i>Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery</i>	119
<b>Report Number 2002-108, Department of General Services:</b> <i>Certain Units Can Do More to Ensure That Client Fees Are Reasonable and Fair</i>	131
<b>Report Number 2002-110, California State University:</b> <i>Its Common Management System Has Higher Than Reported Costs, Less Than Optimal Functionality, and Questionable Procurement and Conflict-of-Interest Practices</i>	137
<b>Report Number 2002-112, Statewide Procurement Practices:</b> <i>Proposed Reforms Should Help Safeguard State Resources, but the Potential for Misuse Remains</i>	153
<b>Report Number I2003-1, Health and Human Services Agency Data Center:</b> <i>Investigations of Improper Activities by State Employees (Allegation I2002-652)</i>	167

<b>Report Number 2002-122, State Controller's Office: Does Not Always Ensure the Safekeeping, Prompt Distribution, and Collection of Unclaimed Property</b>	169
<b>Report Number 2002-113, Governor's Office of Emergency Services: Its Oversight of the State's Emergency Plans and Procedures Needs Improvement While Its Future Ability to Respond to Emergencies May Be Hampered by Aging Equipment and Funding Concerns</b>	181
<b>Report Number 2002-117, Terrorism Readiness: The Office of Homeland Security, Governor's Office of Emergency Services, and California National Guard Need to Improve Their Readiness to Address Terrorism</b>	189
<b>Report Number 2003-105, California Law Enforcement and Correctional Agencies: With Increased Efforts, They Could Improve the Accuracy and Completeness of Public Information on Sex Offenders</b>	197
<b>Report Number I2003-2, University of California, San Francisco: Investigations of Improper Activities by State Employees (Allegation I2000-715)</b>	207

## Education

---

<b>Report Number 2001-120, School Bus Safety II: State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected</b>	211
<b>Report Number 2001-124, Los Angeles Unified School District: Outdated, Scarce Textbooks at Some Schools Appear to Have a Lesser Effect on Academic Performance Than Other Factors, but the District Should Improve Its Management of Textbook Purchasing and Inventory</b>	217
<b>Report Number 2001-130, University of California: Its Partnership Agreement Could Be Improved to Increase Its Accountability for State Funding</b>	229
<b>Report Number 2002-104, California's Charter Schools: Oversight at All Levels Could Be Stronger to Ensure Charter Schools' Accountability</b>	237
<b>Report Number 2002-110, California State University: Its Common Management System Has Higher Than Reported Costs, Less Than Optimal Functionality, and Questionable Procurement and Conflict-of-Interest Practices (see summary on page 137)</b>	
<b>Report Number 2003-107, California Department of Education: The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them (see summary on page 85)</b>	

<b>Report Number 2002-032, California's Education Institutions: A Lack of Guidance Results in Their Inaccurate or Inconsistent Reporting of Campus Crime Statistics</b>	251
---	-----

## Energy, Utilities, and Communications

---

<b>Report Number 2001-123, Deaf and Disabled Telecommunications Program: Insufficient Monitoring of Surcharge Revenues Combined With Imprudent Use of Public Funds Leave Less Money Available for Program Services</b>	257
<b>Report Number 2002-009, California Energy Markets: The State's Position Has Improved Due to Efforts by the Department of Water Resources and Other Factors, but Cost Issues and Legal Challenges Continue (see summary on page 29)</b>	
<b>Report Number 2003-103, California Public Utilities Commission: State Law and Regulations Establish Firm Deadlines for Only a Small Number of Its Proceedings</b>	267

## Environmental Safety and Quality and Toxic Materials

---

<b>Report Number 2002-121, California Environmental Protection Agency: Insufficient Data Exists on the Number of Abandoned, Idled, or Underused Contaminated Properties, and Liability Concerns and Funding Constraints Can Impede Their Cleanup and Redevelopment</b>	275
<b>Report Number 2003-113, California Integrated Waste Management Board: Its New Regulations Establish Rules for Oversight of Construction and Demolition Debris Sites, but Good Communication and Enforcement Are Also Needed to Help Prevent Threats to Public Health and Safety</b>	279
<b>Report Number 2003-102, Water Quality Control Boards: Could Improve Their Administration of Water Quality Improvement Projects Funded by Enforcement Actions (see summary on page 39)</b>	

## Health and Human Services

---

<b>Report Number 2001-012, State of California: Its Containment of Drug Costs and Management of Medications for Adult Inmates Continue to Require Significant Improvements</b>	289
<b>Report Number 2001-129, Department of Health Services: It Needs to Significantly Improve Its Management of the Medi-Cal Provider Enrollment Process</b>	297
<b>Report Number 2001-126, Department of Managed Health Care: Assessments for Specialized and Full-Service HMOs Do Not Reflect Its Workload and Have Disparate Financial Impacts</b>	305

- Report Number 2001-123, Deaf and Disabled Telecommunications Program:** *Insufficient Monitoring of Surcharge Revenues Combined With Imprudent Use of Public Funds Leave Less Money Available for Program Services (see summary on page 257)*
- Report Number 2002-031, Department of Rehabilitation:** *Its Delay in Correcting Known Weaknesses Has Limited the Success of the Business Enterprise Program for the Blind* 309
- Report Number 2002-107, Office of Criminal Justice Planning:** *Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery (see summary on page 119)*
- Report Number 2002-109, Department of Health Services:** *It Needs to Better Control the Pricing of Durable Medical Equipment and Medical Supplies and More Carefully Consider Its Plans to Reduce Expenditures on These Items* 317
- Report Number 2001-015, Statewide Fingerprint Imaging System:** *The State Must Weigh Factors Other Than Need and Cost-Effectiveness When Determining Future Funding for the System* 325
- Report Number 2002-118, Department of Health Services:** *Its Efforts to Further Reduce Prescription Drug Costs Have Been Hindered by Its Inability to Hire More Pharmacists and Its Lack of Aggressiveness in Pursuing Available Cost-Saving Measures* 335
- Report Number 2002-114, Department of Social Services:** *Continuing Weaknesses in the Department's Community Care Licensing Programs May Put the Health and Safety of Vulnerable Clients at Risk* 355
- Report Number 2003-113, California Integrated Waste Management Board:** *Its New Regulations Establish Rules for Oversight of Construction and Demolition Debris Sites, but Good Communication and Enforcement Are Also Needed to Help Prevent Threats to Public Health and Safety (see summary on page 279)*
- Report Number 2003-112, Department of Health Services:** *It Needs to Better Plan and Coordinate Its Medi-Cal Antifraud Activities* 369

## Information Technology

---

- Report Number 2001-128, Enterprise Licensing Agreement:** *The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars (see summary on page 107)*
- Report Number 2002-110, California State University:** *Its Common Management System Has Higher Than Reported Costs, Less Than Optimal Functionality, and Questionable Procurement and Conflict-of-Interest Practices (see summary on page 137)*

## Insurance

---

**Report Number 2001-126, Department of Managed Health Care:** *Assessments for Specialized and Full-Service HMOs Do Not Reflect Its Workload and Have Disparate Financial Impacts (see summary on page 305)*

**Report Number 2002-120, California Veterans Board:** *Without a Clear Understanding of the Extent of Its Authority, the Board Has Not Created Sufficient Policies Nor Provided Effective Oversight to the Department of Veterans Affairs (see summary on page 3)*

## Jobs, Economic Development, and the Economy

---

**Report Number 2002-031, Department of Rehabilitation:** *Its Delay in Correcting Known Weaknesses Has Limited the Success of the Business Enterprise Program for the Blind (see summary on page 309)*

**Report Number 2002-009, California Energy Markets:** *The State's Position Has Improved, Due to Efforts by the Department of Water Resources and Other Factors, but Costs Issue and Legal Challenges Continue (see summary on page 29)*

**Report Number 2003-108.1, California's Workers' Compensation Program:** *The Medical Payment System Does Not Adequately Control the Costs to Employers to Treat Injured Workers or Allow for Adequate Monitoring of System Costs and Patient Care*

383

## Judiciary

---

**Report Number 2001-117, Superior Courts:** *The Courts Are Moving Toward a More Unified Administration; However, Diverse Service, Collection, and Accounting Systems Impede the Accurate Estimation and Equitable Distribution of Undesignated Fee Revenue (see summary on page 45)*

**Report Number 2002-030, State Bar of California:** *Although It Reasonably Sets and Manages Mandatory Fees, It Faces Potential Deficits in the Future and Needs to More Strictly Enforce Disciplinary Policies and Procedures*

395

## Labor, Employment, and Industrial Relations

---

**Report Number 2001-017, Department of Industrial Relations:** *Its Process for Verifying the Status of Licenses Issued to Farm Labor Contractors Is Operational but Needs Some Improvement (see summary on page 25)*

**Report Number 2002-114, Department of Social Services:** *Continuing Weaknesses in the Department's Community Care Licensing Programs May Put the Health and Safety of Vulnerable Clients at Risk (see summary on page 355)*

**Report Number 2003-108.1, California's Workers' Compensation Program:** *The Medical Payment System Does Not Adequately Control the Costs to Employers to Treat Injured Workers or Allow for Adequate Monitoring of System Costs and Patient Care (see summary on page 383)*

## Local Government

---

**Report Number 2001-120, School Bus Safety II:** *State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected (see summary on page 211)*

**Report Number 2001-116, San Diego Unified Port District:** *It Should Change Certain Practices to Better Protect the Public's Interest in Port-Managed Resources* 401

**Report Number 2000-016, Water Replenishment District of Southern California:** *Although the District Has Eliminated Excessive Water Rates, It Has Depleted Its Reserve Funds and Needs to Further Improve Its Administrative Practices (see summary on page 9)*

**Report Number 2001-124, Los Angeles Unified School District:** *Outdated, Scarce Textbooks at Some Schools Appear to Have a Lesser Effect on Academic Performance Than Other Factors, but the District Should Improve Its Management of Textbook Purchasing and Inventory (see summary on page 217)*

**Report Number 2001-125, Red Light Camera Programs:** *Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level* 407

**Report Number 2003-106, State Mandates:** *The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process (see summary on page 75)*

**Report Number 2003-107, California Department of Education:** *The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them (see summary on page 85)*

**Report Number 2002-116, Los Angeles County Metropolitan Transportation Authority:** *It Is Too Early to Predict Service Sector Success, but Opportunities for Improved Analysis and Communication Exist* 419

## Privacy and Public Safety

---

**Report Number 2001-125, Red Light Camera Programs:** *Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level (see summary on page 407)*

**Report Number 2002-101, California Department of Corrections:** *A Shortage of Correctional Officers, Along With Costly Labor Agreement Provisions, Raises Both Fiscal and Safety Concerns and Limits Management's Control* 425

**Report Number 2003-105, California Law Enforcement and Correctional Agencies:** *With Increased Efforts, They Could Improve the Accuracy and Completeness of Public Information on Sex Offenders (see summary on page 197)*

## Public Employees, Retirement and Social Security

---

**Report Number 2001-110, Vacant Positions:** *Departments Have Circumvented the Abolishment of Vacant Positions, and the State Needs to Continue Its Efforts to Control Vacancies (see summary on page 49)*

**Report Number 2002-101, California Department of Corrections:** *A Shortage of Correctional Officers, Along With Costly Labor Agreement Provisions, Raises Both Fiscal and Safety Concerns and Limits Management's Control (see summary on page 425)*

**Report Number I2002-2, Governor's Office of Emergency Services:** *Investigations of Improper Activities by State Employees (Allegation I2000-607)* 431

**Report Number I2003-1, Department of Industrial Relations:** *Investigations of Improper Activities by State Employees (Allegation I2002-605)* 435

**Report Number I2003-1, Health and Human Services Agency Data Center:** *Investigations of Improper Activities by State Employees (Allegation I2002-652) (see summary on page 167)*

**Report Number I2003-1, Department of Developmental Services, Porterville Developmental Center:** *Investigations of Improper Activities by State Employees (Allegation I2002-952)* 439

**Report Number I2003-1, Department of Fish and Game:** *Investigations of Improper Activities by State Employees (Allegations I2002-636, 725, and 947)* 441

**Report Number I2003-2, California Unemployment Insurance Appeals Board:** *Investigations of Improper Activities by State Employees (Allegation I2002-661)* 445

**Report Number I2003-2, Department of Transportation:** *Investigations of Improper Activities by State Employees (Allegation I2002-700)* 449

**Report Number I2003-2, Public Utilities Commission:** *Investigations of Improper Activities by State Employees (Allegation I2002-753)* 451

## Revenue and Taxation

---

**Report Number 2002-124, Franchise Tax Board:** *Its Performance Measures Are Insufficient to Justify Requests for New Audit or Collection Program Staff (see summary on page 57)*

**Report Number 2002-122, State Controller's Office:** *Does Not Always Ensure the Safekeeping, Prompt Distribution, and Collection of Unclaimed Property (see summary on page 169)*

**Report Number 2002-126, California Department of Transportation:** *Low Cash Balances Threaten the Department's Ability to Promptly Deliver Planned Transportation Projects* 455

## Transportation

---

**Report Number 2001-125, Red Light Camera Programs:** *Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level (see summary on page 407)*

**Report Number 2002-103, California Department of Transportation:** *It Manages the State Highway Operation and Protection Program Adequately, but it Can Make Improvements* 459

**Report Number 2002-126, California Department of Transportation:** *Low Cash Balances Threaten the Department's Ability to Promptly Deliver Planned Transportation Projects (see summary on page 455)*

**Report Number 2002-116, Los Angeles County Metropolitan Transportation Authority:** *It Is Too Early to Predict Service Sector Success, but Opportunities for Improved Analysis and Communication Exist (see summary on page 419)*

## Veterans Affairs

---

**Report Number 2001-127, Disabled Veteran Business Enterprise Program:** *Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success* 463

**Report Number I2002-2, Veterans Home of California, Yountville:** *Investigations of Improper Activities by State Employees (Allegation I2000-876)* 473

**Report Number 2002-120, California Veterans Board:** *Without a Clear Understanding of the Extent of Its Authority, the Board Has Not Created Sufficient Policies Nor Provided Effective Oversight to the Department of Veterans Affairs (see summary on page 3)*

## Appendix A

---

*Summary of Recommendations for Legislative Consideration  
by Policy Area* 475

## Appendix B

---

*Summary of Monetary Benefits Identified In Audit Reports  
Released From July 1, 2001, Through December 31, 2003* 483

## Index

---

*State and Local Entities With Recommendations From  
Audits Included In This Special Report* 487

# INTRODUCTION

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This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2002 through December 2003. The purpose of this report is to identify what actions, if any, these auditees have taken in response to our findings and recommendations. We have placed this symbol ☹ in the left-hand margin of the auditee action to identify areas of concern or issues that we believe an auditee has not adequately addressed.

Policy areas that generally correspond to the Assembly and Senate standing committees organize this report. Under each policy area we have included audit report summaries that relate to an area's jurisdiction. Because an audit may involve more than one issue or because it may cross the jurisdictions of more than one standing committee, an audit report summary could be included in more than one policy area. For example, if we audited a computer system at a university, the audit report summary may be listed under two policy areas—Education and Information Technology.

In Appendix A, we have compiled the recommendations we directed to the Legislature. In Appendix B, we summarized monetary benefits such as cost recoveries, cost savings, or increased revenues that we estimate auditees could realize if they implement our recommendations. For example, in our July 2002 report (2002-101) we estimated that the California Department of Corrections could save \$58 million if it reduces overtime costs by filling unmet correctional officer needs. We have also included an index referring to each entity that responded or should have responded to audits included in this report.

For this report, we have relied upon periodic written responses prepared by auditees to determine whether corrective action has been taken. The Bureau of State Audits' (bureau) policy requests that auditees provide a written response to the audit findings and recommendations before the audit report is initially issued publicly. As a follow-up, we request the auditee to respond at least three times subsequently: at 60 days, six months, and one year after the public release of the audit report. However, we may request an auditee provide a response beyond one year or initiate a follow-up audit if deemed necessary.

We report all instances of substantiated improper governmental activities resulting from our investigative activities to the cognizant state department for corrective action. These departments are required to report the status of their corrective actions every 30 days until all such actions are complete.

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of February 2, 2004.

To obtain copies of the complete audit and investigative reports, access the bureau's Web site at [www.bsa.ca.gov/bsa/](http://www.bsa.ca.gov/bsa/) or contact the bureau at (916) 445-0255 or TTY (916) 445-0033.

# CALIFORNIA VETERANS BOARD

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## ***Without a Clear Understanding of the Extent of Its Authority, the Board Has Not Created Sufficient Policies Nor Provided Effective Oversight to the Department of Veterans Affairs***

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### ***Audit Highlights . . .***

*Our review of the California Veterans Board (board) revealed that:*

- The board has not established itself as an effective policy-maker for the Department of Veterans Affairs (department).*
- The board lacks the independent counsel to minimize the legal risks of its policy-making and appeals actions.*
- The board's appeal process needs to ensure that veterans' appeals are handled consistently and appropriately.*
- The board's effectiveness is hindered by its reduced membership and lack of training on its responsibilities.*

*Although the department has implemented eight of the 14 recommendations that were reviewed from our previous audits, it has not given sufficient attention to a key recommendation regarding the long-term viability of the Cal-Vet program.*

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### **REPORT NUMBER 2002-120, JUNE 2003**

**California Veterans Board's response as of January 2004 and the Department of Veterans Affairs' response as of February 2004**

The Joint Legislative Audit Committee (audit committee) requested that we review the California Veterans Board's (board) oversight of the Department of Veterans Affairs (department). Specifically, the audit committee was concerned that the board may not always exercise independent oversight and guidance of the department in a manner that would further the department's mission and goals. Additionally, the audit committee wanted to know the effectiveness of corrective actions the department has taken on our recommendations from previous audits.

### **Finding #1: The board is not an effective policy-maker for the department.**

Although state law gives the board considerable policy-making authority over the department, the board of seven volunteers has established itself as an ineffective policy-maker, unable to strengthen weaknesses in the department's administration of veterans' programs that the Bureau of State Audits (bureau) has reported over the past three years. As an example of the board's inability to effect strong policy, only half of its 32 policies provide direction for departmental operations. Further, although the bureau and other oversight agencies have identified a number of problems within the department, the board has no clearly defined policies to guide and monitor the department's corrective actions. The board has also not used the services of the inspector general for veterans affairs (inspector general) to review the department's operations in areas where board policy could improve the department's delivery of services to veterans.

We recommended that the board assert its policy-making authority by actively identifying areas of the department's operations that it feels need guidance or direction and developing meaningful policies that provide the department with the guiding principles necessary to complete its mission. Using the issues raised in our previous audits and by the inspector general would be a good start for the development of specific policies.

We also recommended that the board monitor the department's corrective actions on external audits by establishing a policy requiring the department to regularly report its progress in implementing corrective actions and when needed, create policies to guide the department's corrective actions.

***Board Action: Partial corrective action taken.***

The board states that it is currently developing a board training manual and researching training programs that will encompass policy-making guidelines. The board believes that these training efforts, along with the assistance of independent counsel, will allow it to develop meaningful policies to provide the department with guiding principles. In addition, the board realizes that the corrective actions from external audits will provide direction for the department's goals and objectives. The board has been working with the department to obtain funding for independent counsel. However, on February 2, 2004, the interim secretary for veterans' affairs declined the board's request for independent counsel, indicating to the board that balanced against the difficult fiscal challenges that all Californians now face, it is his position that the department's attorneys are providing legal advice, counsel on appeals, and aid to the board in a legally acceptable manner consistent with the law and free of conflicts.

**Finding #2: The board has no independent counsel to provide legal advice on its responsibilities.**

Despite the board's important responsibilities for making policy and ruling on veterans' appeals of services that the department has denied, the board does not have an independent counsel it requires to minimize the legal risks of its actions. Instead, the board relies on the department's legal staff for advice. Although they are probably knowledgeable on these laws, the department's legal staff are not the appropriate advisors for the board on policies

under consideration because the board's policies govern the department. Further, the board's rulings on veterans' appeals should have an independent and fair consideration of the department's actions and the veterans' rights to services. Currently, the board must rely on the department's legal staff for advice on appeals, a practice that introduces questions of fairness and impartiality on appeal decisions.

We recommended that to improve the board's ability to independently make decisions on policies and appeals, and to reduce the legal risk created by its present practices, the board should establish a policy to obtain the services of an independent counsel to assist with its policy-making and appeal responsibilities.

***Board Action: Partial corrective action taken.***

The board indicates that it passed a policy citing the need for independent counsel on July 18, 2003, and that as of January 2004 a retired attorney sits on its select committee on policies and procedures. However, as noted previously, on February 2, 2004, the interim secretary for veterans' affairs declined the board's request for independent counsel.

**Finding #3: The board lacks formal written procedures for conducting appeals in a fair and consistent manner.**

Despite the board's existence since 1946, it has no formal written procedures outlining or detailing instructions for processing appeals at an operational level. Further, the board does not have a clear understanding of the type of appeal procedures it should follow, which could result in the board conducting a more formal hearing on an appeal than is warranted or not giving veterans an adequate degree of protection. Without a set of formalized procedures, the board cannot ensure that its members have the same understanding of how to conduct appeals, nor can it be certain that members' actions are consistent. However, to give veterans the fair treatment they deserve and expect, and to avoid legal risks, the board must be able to process all veterans' appeals consistently and professionally. In addition, the board relies upon the department's chief counsel to preside over formal hearings on appeals. However, as a member of the department's management team and potentially a participant in the decisions to deny services, the chief counsel is not in a position to act in an unbiased manner.

To ensure that the board consistently and fairly reviews veterans' appeals of services that the department has denied, we recommended that the board should create a policy establishing formal written procedures for conducting appeals. In addition, to ensure that every veteran's appeal is heard in the proper forum, the board should acquire the expertise to determine the appropriate type of hearing for each appeal. In addition, to avoid the appearance of bias in its appeal decisions, the board should discontinue having the department's chief counsel preside over formal hearings.

***Board Action: Partial corrective action taken.***



The board states that it is currently developing a training manual that will include specific steps for reviewing and conducting appeals. Further, to avoid the appearance of partiality in the appeal process, the board was working with the department to obtain the services of independent counsel. However, as noted previously, on February 2, 2004, the interim secretary for veterans' affairs declined the board's request for independent counsel.

**Finding #4: With a reduced membership, the board may lack the expertise the Legislature intended and may be unable to hold meetings.**

The board's effectiveness has been hindered over the past few years because it has rarely comprised the seven members authorized by the Military and Veterans Code. The governor appoints board members and five board members must have expertise in a particular area required by law. Without these expert members, the board might be limited in its understanding of departmental issues and veterans' appeals. Additionally, its reduced membership could prevent it from meeting the quorum of four required by board policy to conduct business.

To assist the governor in promptly appointing members to fill both the current and future vacancies, we recommended that the board proactively identify possible board members when vacancies occur.

***Board Action: Pending.***

The board states that there are three vacancies on the board as of January 15, 2004 and it is waiting for the Governor to appoint new members. It currently receives calls from veterans interested in joining the board, and redirects those veterans to the Governor's appointment office.

**Finding #5: To be an effective oversight and policy-making body, the board needs to adequately train its members.**

Contributing to the board's deficiencies as a policy-making and oversight body is the fact that members receive no formal training regarding the laws and regulations controlling veterans' affairs; board policies, duties, and authority, including how to conduct appeals; departmental operations; state laws regarding open meetings; and state laws regarding the privacy of medical information. Insufficient training may have caused the board to violate state open-meeting laws and possibly resulted in two instances of the board discussing veterans' confidential medical records in public board sessions.

To enable board members to perform their oversight functions effectively, we recommended that the board provide ongoing training to its members in topics related to their responsibilities.

***Board Action: Partial corrective action taken.***

The board states that it is currently developing a training manual that will include areas on policy making, duties and authority, the appeal process, department operations, state laws regarding open meetings, and state laws regarding the privacy of medical information. However, at this time the board can only send board members to ethics training due to budget constraints.

**Finding #6: Despite implementing many recommendations we made in previous audits, the department has not sufficiently addressed an important issue for the Cal-Vet program.**

The board's weak policy-making deprives a problem-prone department of needed assistance in improving on weaknesses documented in reviews by the bureau and other oversight agencies.

Our follow-up on recommendations we made to the department in two previous audits revealed that the department has implemented eight of the 14 recommendations we could reasonably expect the board to address. However, the department has not given sufficient attention to a key recommendation regarding the long-term viability of the Cal-Vet program, the department's loan program that helps veterans purchase farms or homes. As mentioned in our previous audits, unless there is a change in federal tax laws, fewer and fewer veterans will benefit from the Cal-Vet program because federal tax restrictions have limited eligibility for loans backed by the bonds that supply the majority of the program's funding. Despite two previous unsuccessful efforts, the department is attempting to change federal tax laws to make more veterans eligible for the Cal-Vet program. However, the department has not performed sufficient contingency planning for the potential reduction in the Cal-Vet program's funding should its efforts fail again.

To ensure effective and efficient operations, the department should continue to address the recommendation of our prior audits, especially the recommendations regarding the long-term viability of the Cal-Vet program.

***Department Action: Pending.***

Although we anticipated that the department would respond to this finding, the board submitted a response to us. The board indicates that it will continue to address the bureau's concerns regarding the Cal-Vet program once it obtains independent counsel.

# WATER REPLENISHMENT DISTRICT OF SOUTHERN CALIFORNIA

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## ***Although the District Has Eliminated Excessive Water Rates, It Has Depleted Its Reserve Funds and Needs to Further Improve Its Administrative Practices***

REPORT NUMBER 2000-016, MAY 2002

Water Replenishment District of Southern California's  
response as of October 2003

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### ***Audit Highlights . . .***

***Although the Water Replenishment District of Southern California (district) has lowered its accumulated reserve funds and assessment rate, it lacks a long-term vision of its financing needs. In addition, the district lacks adequate planning for its capital improvement projects and adequate accounting and administrative controls over its operating expenses. Specifically, our review revealed that the district:***

- Lowered its reserve funds from \$67 million in 1998 to a projected balance of \$6 million at June 30, 2002, without establishing a minimum level of funds necessary to meet its responsibilities.***
- Has not identified an optimum quantity of groundwater to be stored in the basins, although groundwater has dropped by 110,000 acre-feet.***

*continued on next page*

The Water Replenishment District of Southern California (district) was established in 1959 to counteract the effects of overpumping the groundwater in the West Coast and Central basins (basins). The California Water Code (water code) grants the district broad powers to do what is necessary to replenish and maintain the integrity of the basins. In December 1999 the Bureau of State Audits (bureau) issued a report concluding that the district's poor management had led to its charging those who pump groundwater an excessively high replenishment assessment (assessment rate). Because that report raised significant issues, the Legislature amended the water code to ensure that the district implemented the bureau's recommendations. The amendments also required the bureau to perform this follow-up audit of the district's operations and management.

### **Finding #1: The district has significantly reduced its reserve funds and stored groundwater quantities have declined.**

One of the bureau's 1999 recommendations was that the district should reduce its reserve funds, which totaled \$67 million in 1998. The district responded by lowering its reserve funds to a projected balance of slightly more than \$6 million by June 30, 2002. We believe that this significant depletion may pose a threat to the district's ability to maintain the current quantity of groundwater in the basins. The district uses its reserve funds to ensure an adequate supply of groundwater, to stabilize its assessment rate, and to develop capital improvement projects that increase the reliable supply of clean groundwater in the basins. In spite of the current low level of reserve funds, the district has not established a minimum level of funds necessary for it to meet its responsibilities.

- ☑ *Does not adequately explain its calculation of the assessment rate.*
  - ☑ *Spent \$19.9 million on capital improvement projects in the last two fiscal years and has appropriated \$12 million more, even though it does not have current strategic and capital improvement plans.*
  - ☑ *Invested in projects without understanding their full costs or ensuring that it would receive the benefits it anticipated.*
  - ☑ *Paid for services not covered under contracts and has not enforced all the terms of its contracts.*
  - ☑ *Lacks written purchasing procedures and has not adequately enforced its existing policies.*
- 

The district's ability to build the reserves to pay for these needs may be complicated by legal constraints. Beginning in fiscal year 2000–01, the water code limited the district's reserve fund balance to \$10 million, an amount that the district may adjust in subsequent years to reflect changes in the annual cost of the district's water purchases. In addition, the water code states that the district must earmark at least 80 percent of its reserves for water purchases, leaving the remainder for all other purposes. Because the district has not analyzed its other needs for reserve funds, however, it cannot state definitively that the 20 percent allowed for these needs is not enough.

Compounding the situation, the quantity of groundwater stored in the basins has declined by more than 110,000 acre-feet between October 1998 and September 2001, eroding about 30 percent of the progress made in replenishing the basins since water year 1961–62. The district has not established an optimum quantity for groundwater it should store or a minimum quantity it needs to assure an adequate supply of water to the basins' users. Without establishing targeted groundwater quantities, the district cannot fully justify its water purchase expenditures.

To ensure that it has sufficient funds to meet its statutory responsibilities, the district should adopt a policy on a minimum reserve fund balance. That policy should specify the amount of reserves it requires to meet all of its necessary expenses, including those associated with its operations, the stabilization of its assessment rate, its ability to respond promptly to contamination issues, and its ability to repair and replace its facilities and equipment. If the district determines that it needs more reserve funds than the water code currently permits, it should consider seeking legislative approval for an increase in the allowed level.

To ensure an adequate supply of water for the basins' users, we also recommended that the district establish an optimum quantity for stored groundwater that can serve as a target for its water purchases. It should also establish a minimum quantity below which it should not allow the basins to fall.

***District Action: Corrective action taken.***

The district states that its board of directors (board) adopted a new reserve policy on March 17, 2003. The new reserve policy will be the basis for seeking legislative approval of statutory changes to the water code that will allow the district to accumulate a larger reserve than the current \$10 million limit. In addition, the district states that it has identified, and the board has adopted, optimum and minimum water quantities for stored groundwater.

**Finding #2: Several factors have contributed to the depletion of the district's reserve funds.**

Since fiscal year 1997–98 the district has depleted its reserve fund balance through a combination of lowered assessment rates, increased water replenishment purchases, capital improvement expenditures, and grants to ratepayers, totaling \$30 million, through its Clean Water Grant program. However, the district's past decisions indicate that it lacks a long-term vision for its finances, which has led to poor management of its reserve funds and of the assessment rate it charges ratepayers.

After years of increases in its assessment rate, resulting in a historical high of \$162 per acre-foot in the mid-1990s, the district lowered its rates beginning in fiscal year 1997–98. By fiscal year 2000–01, the district charged \$112 per acre-foot, a rate that it continued in fiscal year 2001–02 even though its annual Engineering Survey and Report (engineering report) and budget efforts indicated that it should have charged the maximum allowable rate of \$116 per acre-foot.

Under current statutory restrictions the district can only charge \$117 per acre-foot in fiscal year 2002–03. In its draft 2002 engineering report, the district estimates that water replenishment costs alone will account for \$112 of the \$117 proposed rate. This leaves only \$5 per acre-foot for the district's other expenditures, which for fiscal year 2002–03 the district estimates to be \$37 per acre-foot. The district's proposed budget for fiscal year 2002–03 indicates that if it adopts this assessment rate, it must make cuts in either water purchases or capital improvement project spending in order to balance its budget and provide for a minimum level of reserve funds.

The district cannot immediately recover financially from its past decisions. Currently, the water code limits the district to raising its rate by the local consumer price index (CPI) plus 1 percent, with a maximum 5 percent increase above the previous year's assessment. However, the CPI may not be the most appropriate index by which to restrict assessment rate increases since it is reflective of consumer inflation, not necessarily of increases to the district in its cost of water purchases. This limitation is set to expire on December 31, 2002, although the Legislature may choose to extend that restriction.

Complicating the district's finances, current law prohibits the district from incurring debt to pay for capital improvement projects. Under the district's interpretation, in addition to prohibiting the district from selling bonds, this provision also prevents the district from incurring debt to take advantage of state-operated programs to assist in groundwater recharge and storage projects. This provision of the law also expires on December 31, 2002, unless the Legislature extends it.

We recommended that the district's board set the annual replenishment assessment at a rate that will support the district's planned activities and ensure that it maintains the level of reserve funds it needs to meet its statutory responsibilities. Furthermore, if restrictions on increasing assessment rates are extended past December 31, 2002, the district should consider seeking legislative approval of statutory changes that will increase its flexibility to raise funds for its operations, capital improvement projects, and reserves.

***District Action: Partial corrective action taken.***

Although the district states that it will determine the assessment rate that is required to maintain an adequate reserve balance, for its fiscal year 2003–04 budget the district's board did not adopt an assessment rate that attempts to achieve an adequate reserve of funds, within the limits of the law. The board adopted a reserve policy to accumulate and set aside about \$20 million, but the law currently limits the district to a \$10 million reserve. However, in spite of the new policy on adequate cash reserves, for its fiscal year 2003–04 budget the district's board adopted an annual assessment rate that will allow the district's reserve funds to fall to a projected \$5 million—below the \$6 million projected balance for June 30, 2003, we cite in our report.

***Legislative Action: Legislation passed.***

Assembly Bill 1163 (Chapter 941, Statutes of 2002) was enacted in September 2002 to delete the prohibition on the district to incur debt. The restrictions from prior legislation regarding limits on annual increases in the district's assessment rate expired on December 31, 2002. This bill also includes a provision that requires the state auditor to perform an audit of the district's operations and management and an evaluation of the extent to which the district has complied with recommendations the state auditor reported in May 2002. The state auditor shall submit its audit report to the Legislature no later than June 30, 2004, and the cost of the audit shall be reimbursed by the district's ratepayers.

**Finding #3: Due to shortcomings in the district's budget process, its spending needs do not tie to its assessment rate.**

The amount the district determines it must collect from the replenishment assessment is driven in part by the costs it budgets for capital improvement projects and other programs. However, in reviewing the district's fiscal year 2001–02 budget, we found that the district's staff have been inconsistent about including supporting information, their preparation of certain elements of the budget has been inaccurate, and they have allocated shared administrative costs inappropriately. The district has not exercised strong managerial oversight over its budgeting process, nor has it provided the staff who prepare the budget with sufficient, documented direction.

In addition to weaknesses in preparing its spending plan, the district does not tie its affirmed spending needs to the assessment it levies on ratepayers who pump groundwater from the basins. Moreover, the data contained in the annual engineering reports that the district prepares to meet certain requirements of the water code and identify water replenishment needs does not clearly explain the amount of water the district determines it must purchase. As a result, ratepayers have criticized the district over the validity of its budgeted expenses and the need for the assessment rate it charges.

We recommended that the district implement comprehensive written procedures for preparing its annual budget. These should provide staff who prepare the budget with adequate direction in meeting the standards that the district's management and directors develop for supporting information, overhead allocation, proper classification of expense items, and document retention.

To allow for a thorough public discussion of the district's proposed assessment rate, district staff should tie the district's spending plan to its calculation of the rate. The district should distribute this presentation to the board for public hearings and should distribute to attendees a presentation that includes, at a minimum, adequate data to support the proposed rate. This data should be drawn from the district's engineering report, proposed budget, and capital improvement plan.

***District Action: Corrective action taken.***

The district states that its controller has already issued preliminary policies and procedures and assumed responsibility for maintaining a central budget file. The controller is also responsible for the continued implementation of written policies and procedures over budget preparations. The district reports that it prepared its fiscal year 2002–03 budget using an administratively feasible method for allocating overhead to projects and programs, and for identifying replenishment and clean water program and project costs. Additional guidelines for using historical cost information, providing reasonable information for budget items, and classifying capital and noncapital expenses were developed during the fiscal year 2003–04 budget process.

**Finding #4: The district lacks updated strategic and capital improvement plans.**

The district does not have current strategic and capital improvement plans that identify and prioritize the implementation of its capital improvement projects. Without such plans, the district cannot be certain that it identifies and implements the projects with the greatest impact on the supply of safe water in the basins. In addition, these plans can be important for giving the district's taxpayers a clear view of the long-term direction of the district and a better understanding of its ongoing needs for revenue to fund capital improvement projects. The district is creating a strategic plan to replace the plan it prepared in 1998. Although its ability to begin new projects is limited by its low reserve funds and legal restrictions that prohibit it from incurring debt, the district has spent \$19.9 million on capital improvement projects in the past two fiscal years and has earmarked another \$12 million for current projects. Moreover, the legal constraints are scheduled to expire on December 31, 2002, unless the Legislature extends them. Current strategic and capital improvement plans are therefore crucial to the district's ability

to effectively and efficiently meet its statutory responsibilities. We believe that the most effective process for developing these plans would include the participation of those whom the district's programs and projects most affect, the district's ratepayers.

We recommended that the district continue to create an updated strategic plan and capital improvement plan to identify the programs and capital improvement projects that will aid it in fulfilling its mission. These plans will be most beneficial to the basins the district serves if the district incorporates the following activities into their development:

- Assess all activities it performs and their priority to the district's role versus the activities and roles of other water agencies in the region.
- Ensure that the plans clearly identify which projects are ongoing and prioritize the proposals in the order of importance to meeting the district's statutory requirements.
- Share with ratepayers the appropriate level of information on proposed programs and projects, including cost and benefit estimates.
- Periodically update its strategic and capital improvement plans to ensure that it bases decisions for future projects on appropriate and current information.

***District Action: Corrective action taken.***

The district reports that its board adopted a revised strategic plan on September 3, 2003. In addition, the district states it has developed a draft capital improvement plan, including projects and programs that are clearly identified as new or ongoing. The district anticipates the capital improvement plan will be ready for board adoption by the end of 2003. The district also states it will develop a policy for periodically updating strategic and capital improvement plans.

***Legislative Action: Legislation passed.***

Assembly Bill 1163 (Chapter 941, Statutes of 2002) was enacted in September 2002 to require the district to develop and update a five-year capital improvement program using input from a technical advisory committee made up of water professionals appointed by the Central Basin Water Association and the West Basin Water Association (technical advisory committee).

**Finding #5: The district has failed to identify and resolve risks in proposed capital improvement projects.**

Despite the fact that over the past two fiscal years it has spent \$19.9 million on capital improvements, the district lacks a standard process for identifying and resolving the risks attached to potential projects and for evaluating the projects' costs and benefits. As a result, the costs of some projects are likely to exceed the district's estimates, and it may not gain the benefits it expected. For instance, the district invested \$10.3 million in the Goldsworthy Desalter facility (desalter) to remove saltwater contamination from the West Coast Basin without seeking clarification as to whether it would need legal rights to pump the saltwater from the basin. When the district sought this clarification, the court determined the level of salinity of the extracted water necessary to exempt the district from obtaining legal pumping rights to be higher than the district had planned when it built the desalter. If the water pumped by the district does not reach that level of salinity, the district's operating costs will increase or it may have to invest up to an additional \$2.3 million to qualify the desalter for a subsidy of its operating costs.

In addition, the district started construction in October 2001 on the Alamitos Barrier Recycled Water Project (Alamitos Barrier project), which the district estimates will cost \$11.7 million, even though it has yet to resolve a critical issue that may keep it from operating. It has not yet reached final settlement with Los Angeles County (county) on an agreement to compensate a third party affected by the project, even though the district first identified the need to resolve this condition as early as 1997. The Alamitos Barrier project is scheduled for completion in November 2002, but without a resolution to this issue, the district will not be able to begin operating the facility.

In our December 1999 audit report, we recommended that the district standardize its process for preparing cost-benefit analyses for the capital improvement projects it considers for development. However, the district has not yet implemented such a policy. In a cost-benefit analysis, the district should define and evaluate the costs and perceived benefits of a proposed project and alternative projects, thus allowing it to make reasonable, informed decisions and to choose between different strategies. Further, the district should follow a consistent approach in preparing its analyses in order to avoid skewing the results in favor of projects it wants to do. Although the district states that it regularly conducts financial evaluations of its capital improvement projects, it does not have

documented procedures for its staff to follow in performing cost-benefit analyses. The lack of a standard policy may result in inconsistent or poor analyses, which in turn may cause the district to forgo beneficial projects or spend its limited funds on less-desirable alternatives.

The district should establish a standardized approach to evaluating and selecting capital improvement projects. At a minimum, the approach should include the appropriate steps to identify legal, technical, and financial risks of proposed projects. Also, the district should implement a cost-benefit analysis methodology that (1) defines standards and assumptions to use when evaluating replenishment projects and (2) offers a process for weighing alternative solutions to contaminant mitigation issues.

Moreover, the district should quickly define potential resolutions to the water rights issue involving the desalter and implement the most suitable solution to put the desalter to work permanently removing saltwater from the West Coast Basin. In addition, the district should promptly come to agreement with the county to resolve the third-party compensation issue that could potentially prevent the operation of the Alamitos Barrier project.

***District Action: Partial corrective action taken.***

The district states that district managers will identify capital projects necessary to meet the goals of the plan. In cooperation with the technical advisory committee, it will develop a standardized approach to identify the legal, technical, and financial risks of proposed capital projects. Once the district has identified the cost and benefits of proposed projects, it will seek recommendations from the technical advisory committee and board approval to move forward with a particular project. Based upon the evaluation of projects using these criteria and board approval, the district will develop implementation schedules based on the priority of cost-effective projects, cooperative opportunities, and available funding. In addition, the district reported that it had received from the court an extension of time for its desalter to reach the chloride levels required in the operating criteria. In November 2002, the desalter reached those levels. Finally, the district and the county have finalized the resolution to the issue related to the Los Alamitos Barrier project.

**Finding #6: The district has not managed all of its contracts effectively.**

The district has not always signed contracts prior to receiving and paying for professional services and has at times paid for services that are not included in the scope of its contracts. For example, the district paid one of its general counsels almost \$112,000 during 2001 for the services of a public relations firm, even though the general counsel's contract did not include public relations in its scope or authorize the hiring of subcontractors.

Also, the district's current contracts with three legislative advocacy firms and three law firms do not specify the duration of the agreements. The district entered into most of these contracts between 1998 and 2000, although one dates to 1989. For the six firms combined, the district paid more than \$1.4 million in 2001. Although the district correctly points out that it signed the contracts prior to the current requirement that all contracts contain duration, we believe the current requirement reflects sound business practice for all contracts.

Moreover, the district did not enforce the terms of one of its contracts on which it paid a fixed amount of \$21,500 per month, and district staff did not follow the board's policy or instructions when signing another contract for which it paid \$25,000 in 2001. The district has also entered into agreements with legal, legislative advocacy, and public relations firms for fixed monthly fees of up to \$10,000 per month, but it could not provide evidence that it regularly reviews its needs for these services. As a result, it may be paying for unneeded services or overpaying for the value it receives. Finally, the district does not maintain an adequate file of its contracts. In two instances we found that the district maintained duplicate contracts for legal and legislative advocacy services.

In spite of the lingering weaknesses in the district's management of its contracts, some provisions imposed by the water code and the district's Administrative Code (district code) appear too restrictive. In response to our December 1999 audit report, one requirement the Legislature placed on the district's contracting practices requires that the board president and secretary sign all contracts and other documents that the district enters into. Although this requirement allows the district's board complete oversight of contracting practices, it has the potential of being administratively burdensome for contracts below certain dollar thresholds. Similarly, the district enhanced the contracting

provisions in its policies by adopting certain portions of the California Public Contract Code into the district code. However, one of the provisions in the district code places burdensome restrictions on the district's contracting practices by requiring a formal written process for requesting proposals for most contracts and requires board approval of all contract solicitations for professional services, regardless of dollar amount.

To ensure that it maintains the proper level of control over the services it receives from various consultants, we recommended that the district improve its contract management procedures by taking the following steps:

- Develop scope-of-services provisions for its contracts that clearly define the tasks it requires from contractors and provide the district with clear criteria for evaluating the contractors' performance.
- Ensure that the district and professional services contractors sign a written agreement.
- Specify duration that identifies a starting point and ending point in all contracts.
- Ensure that it enters into contracts that are consistent with the board's directions and that contracts are signed only by those authorized to do so.
- Separate contracts into active and inactive files to facilitate easier identification of the contracts under which it may have obligations.

We also recommended that the district renegotiate existing contracts so that they are consistent with current minimum standards that the Legislature mandates, which require scope-of-service, duration, and payment terms.

To ensure that it receives all of the services and products that its contracts specify, the district should assign staff of appropriate levels to monitor the contractors' performance. Moreover, the district should implement procedures to periodically evaluate any contracts that require fixed monthly fees to ensure that it receives services in keeping with the fees it pays.

Finally, we recommended that the district consider seeking legislative changes to the water code to allow the board to delegate the authority to sign contracts and amend the district code to allow more efficiency in procuring goods and services.

***District Action: Corrective action taken.***

The district states that it has taken steps to strengthen its contract management policies and procedures, including assigning management staff to serve as contract managers, reviewing current contracts to ensure they comply with applicable legislative mandates, and implementing annual quality reviews of services before renewing any contracts.

**Finding #7: Despite amendments to its policies, the district could further improve its controls over purchases and travel reimbursements.**

Although it has improved its procurement policies, the district could further improve its controls over purchases of goods and services, as well as reimbursements to staff, consultants, and board members for travel costs. At the time of our audit, the district lacked written accounting procedures to govern cash disbursements and purchasing. This lack of standardized procedures has led to inconsistent practices and insufficient managerial control over purchase and payment approvals—in fact, at the time of our review, the district had no formal requirement that managers preapprove purchases. Although many of these payments are small compared to the district’s overall spending, the lack of adequate controls can promote a culture that is contrary to the stewardship imposed on the district as a public agency.

Further, the district has not always ensured that the costs its directors incur for conferences and travel are reasonable and necessary, as the district code requires. Consequently, the district may not be benefiting from all of the conference and travel costs it reimburses. For example, it reimbursed two of its directors a total of more than \$7,700 for travel and conferences without documentation of the reasonableness of their expenses and the benefit of the trips to the district.

In addition, the district has not adequately controlled reimbursements to managers, directors, and consultants for travel and meal expenses. The district’s policy states that employees can be reimbursed for travel and meal expenses, within defined dollar limits, only outside a defined local area, and requests for expense reimbursement must be submitted within 90 days. However, we found that the district reimbursed its interim general manager \$915 for local meals purchased over

a nine-month period, reimbursed one director for meal expenses in excess of the established limits, and reimbursed consultants nearly \$3,000 without obtaining the business purpose of the expenses.

We recommended that to better control its administrative costs, the district should continue its development and implementation of written accounting procedures. It should ensure that these procedures require that only authorized staff approve purchases of goods and services and approve payments to vendors or consultants, and staff maintain documents that demonstrate efforts to ensure that the district receives value for purchases that do not require formal bidding.

Before approving reimbursement for travel or conference costs for its members, the district's board should ensure that travel or conference costs will benefit the district's public purpose.

We also recommended that the district adopt a policy that holds contractors to the same expense reimbursement guidelines as district staff.

***District Action: Partial corrective action taken.***

The district reports that its controller is responsible for the continued development and implementation of written accounting procedures. A copy of the district's draft Accounting Procedures Manual was distributed to the district's Finance Committee in September 2003 for review and comment.

**Finding #8: The district's administrative code could provide better guidance on procurement.**

The district's policies continue to omit some critical elements of contracting practices that we identified in our previous report. Specifically, the district code does not prohibit staff from writing requests for proposals that effectively limit bidding to one bidder or altering requirements that could affect the evaluation of the bids after the district issues final requests for proposals. In addition, the district code broadly exempts certain contracts, such as those for retaining expert witnesses to provide consulting or testimony, from its procurement policy.

In addition, the district code is silent on the board's position as to which types of expenditures promote the district's public purpose. During 2001 the district spent more than \$500 for

flowers for employees, directors, and nonemployees; it also spent almost \$3,500 for its annual holiday party. However, we did not find a district policy that establishes a reasonable basis for its position that these expenses support the district's public purpose, and as a result, we believe that these payments are gratuities and thus a gift of public funds. The district also paid \$2,000 to co-sponsor a dinner at the National League of Cities annual conference in Boston, Massachusetts. The district justified the cost by stating that many Los Angeles-area cities had representatives at the event, but otherwise it could not demonstrate how the expense furthered its public purpose, nor could it provide evidence that the board considered the necessity and reasonableness of the expense before approving it.

Finally, as we noted in our previous report, the district code does not provide adequate guidance in its travel reimbursement policies, rather, it requires only that the lodging be moderate and necessary. In the absence of adequate policies and procedures, the district paid room charges of up to \$280 per night for hotel stays in Sacramento, where less expensive lodging is widely available.

We recommended that the district amend the district code to provide the following:

- Requests for proposals that do not effectively eliminate bidders. In addition, it should prohibit altering material factors that could affect the evaluation of bids after it has issued final requests for proposals.
- Better guidance to district staff on allowable and unallowable expenses. Specifically, the board should adopt a policy regarding the types of expenses it believes promote the public purpose of the district.
- Better guidance for reimbursable lodging expenses, including dollar thresholds and a process for justifying charges in excess of those thresholds.

***District Action: Corrective action taken.***

The district reports that it has amended its administrative code to ensure that it meets our recommendation regarding requests for proposals, allowable and unallowable expenses, and guidance for reimbursable lodging expenses.

**Finding #9: The district has not fully complied with mandated reporting requirements.**

Amendments to the water code require that, effective January 1, 2001, the district present estimates of the costs to complete and the funding sources for its capital improvement projects in its annual audited financial statements and that it also include a report from its independent auditor evaluating the propriety of its operating expenses. However, the district included an incorrect list of capital improvement projects in its audited financial statements and overstated their estimated costs by \$3.6 million. In addition, the district did not include the required report on the propriety of its operating expenses.

Although the water code limits the amount of reserve funds the district may accumulate, it does not require the district to disclose its compliance with this provision in its audited financial statements. In its June 30, 2001, financial statements, the district voluntarily included a calculation intended to show that it complied with the water code's restrictions. However, the district erred in its calculation and understated its accumulated reserve funds at June 30, 2001, by \$4 million. Although it exceeded the water code's limitation of \$10 million in reserve funds for fiscal year 2000–01, the district has properly applied the excess to capital improvement projects and water purchases in its fiscal year 2001–02 budget.

We recommended that to provide reliable information on its operations as the Legislature intended, the district take the necessary steps to ensure that it complies with the reporting requirements of the water code. It should include in its audited financial statements an accurate and complete list of its capital improvement projects and their funding sources as well as a report on the propriety of the district's operating expenses. In addition, the district should ensure that it accurately calculates any disclosure of reserve funds it includes in its audited financial statements.

***District Action: Corrective action taken.***

The district submitted audited financial statements for the fiscal year ended June 30, 2002, that include the reporting requirements of the Water Code.



# DEPARTMENT OF INDUSTRIAL RELATIONS

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## ***Its Process for Verifying the Status of Licenses Issued to Farm Labor Contractors Is Operational but Needs Some Improvement***

REPORT NUMBER 2001-017, SEPTEMBER 2002

Department of Industrial Relations' response as of October 2003

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### ***Audit Highlights . . .***

*Our review of whether the Department of Industrial Relations (department) has established a process for verifying the status of state licenses issued to farm labor contractors revealed that:*

- The department's process for verifying the status of farm labor contractors' licenses has been operational since July 1, 2002.*
  - Agricultural growers, farm labor contractors, and others can request license verifications through the department's Web site or by electronic mail, telephone, or facsimile.*
  - More oversight is needed of the department's license verification process, especially in these early stages of implementation.*
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Chapter 157, Statutes of 2001, amended Section 1695.7(e) of the Labor Code, and required the labor commissioner in the Department of Industrial Relations (department) to establish a unit for verifying the status of farm labor contractors' licenses by July 1, 2002. According to the amended code, agricultural growers and farm labor contractors that subcontract work must verify that a farm labor contractor is properly licensed. The Bureau of State Audits was required to certify that the department's unit responsible for these verifications is operational. Based on our review, we found the following:

### **Finding #1: Although the department's license verification process is operational, the unit manager should exercise more oversight.**

The department's new verification process is sufficient to certify the status of a farm labor contractor's license within one business day of receiving a request, provided employees follow established procedures. The unit manager oversees the verification process and has significant review capability over requests received and responded to electronically—the most common submission and delivery method. However, the unit manager is less able to monitor requests and responses to requests that are not electronic, such as requests received over the telephone or fax, or responses sent by fax or mail. Although the five employees assigned to the verification function are required to maintain folders containing documentation of fax and telephone requests and evidence of the corresponding responses, the unit manager had not had a chance to review these files at the time of our testing. Consequently, the unit manager has less assurance that telephone and fax requests as well as mail and fax responses are processed appropriately.

In addition, the unit does not accurately compile statistics concerning the number and types of verification requests received. The unit needs to have accurate information concerning its workload so it can assign an appropriate amount of resources to this function.

To ensure that the department is complying with the requirement that it respond to requests for verification of farm labor contractor licenses within one business day, we recommended that the unit manager exercise more oversight. For example, the unit manager could develop a log for employees to record the date, time, and medium (online, fax, e-mail, or telephone) by which a request is received; the date and time that the employee transmits the verification; and the method by which he or she transmitted the verification (e-mail, fax, or mail). The unit manager could then review the logs to ensure that a response was recorded for every request. The unit manager could also compare the number of requests received to the number of unique verification numbers issued. The logs would also provide statistical information on the unit's workload.

***Department Action: Partial corrective action taken.***

➡ The department reports that the unit manager reviews all incoming e-mail and fax requests daily to ensure that responses have been made. The department asserts that it has responded to all requests received in a timely manner. However, the department's response does not explain how it ensures that telephone requests are processed appropriately.

➡ Finally, the department reports that it has kept statistics that reflect the number of requests and the method by which they are received. However, the department's response does not address our finding that these statistics are inaccurate.

**Finding #2: The department has not established dedicated telephone and fax lines for license verification requests.**

The department has not established a dedicated telephone line for license verification requests. Consequently, unit employees who are not trained to perform verifications of farm labor contractors' licenses occasionally answer incoming telephone calls and attempt to gather relevant information from the requestor. This practice increases the chance of

miscommunication between the requestor and the unit employee working on the verification. Similarly, the department does not have a fax machine dedicated to license verification requests. Rather, faxed requests are received in a general work area by a fax machine used by the entire unit. The lack of a dedicated fax machine increases the risk of misplacing a faxed license verification request.

To reduce the possibility that a request for verification is lost or incorrectly handled, we recommended that the department consider obtaining dedicated telephone and fax lines and a fax machine for this function.

***Department Action: Corrective action taken.***

The department reports that it received 369 requests for verification of licenses via fax in the first 12 months of operation. The department does not believe it is necessary to have a fax machine dedicated to license verification requests.

Additionally, the department reports that it received 568 license verification requests over the telephone in the first 12 months. The department does not believe that it is necessary to incur the costs of installing a telephone line dedicated to this function.

**Finding #3: The department does not accept telephone requests on all state business days.**

Although the license verification Web site indicates that requests can be submitted by calling the Fresno or San Francisco office, neither office accepts telephone requests on Thursdays, and the San Francisco office does not accept telephone requests on Tuesdays as well.

To be more responsive to its customers, we recommended that the department consider taking telephone requests for license verification on all state business days.

***Department Action: Corrective action taken.***

The department reports that it now accepts telephone requests for license verifications on all state business days.



# CALIFORNIA ENERGY MARKETS

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## ***The State's Position Has Improved, Due to Efforts by the Department of Water Resources and Other Factors, but Cost Issues and Legal Challenges Continue***

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### *Audit Highlights . . .*

*The Department of Water Resources (department) has renegotiated 23 power contracts with 14 suppliers to improve the energy delivery, financial, and legal aspects of these contracts. In addition, the investor-owned utilities are once again responsible for purchasing the net short.*

- The portfolio better fits California's power needs due to changes in energy products and a reduction of forecasted demand.*
- Reported contract cost reductions were estimated at \$5.5 billion on a nominal basis and based on assumptions at the time of the renegotiations.*
- Based on March 2003 market assumptions, replacement power costs, and discounting to present value, the department consultant currently estimates ratepayer savings as \$580 million.*
- The legal terms and conditions of the restructured contracts significantly improved reliability, but the department remains restricted in its ability to assign contracts.*

*continued on next page*

### REPORT NUMBER 2002-009 APRIL 2003

### Department of Water Resources' response as of November 2003

The California Water Code, Section 80270, requires the Bureau of State Audits to conduct two financial and performance audits of the Department of Water Resources' (department) implementation of the power-purchasing program: the first due by December 31, 2001, and the second due by March 31, 2003. We completed the first required audit on December 20, 2001, and this audit fulfills the requirement for the second audit report. In this audit, we follow up on the department's actions with respect to the recommendations from our 2001 audit. To assist us in forming our conclusions related to the economic issues involved, we retained the services of an energy economics firm to perform various analyses.

#### **Finding #1: With renegotiated contracts and a reduction in forecasted demand, the contracted electricity portfolio better matches California's needs and better tracks changes in fuel costs.**

The department has renegotiated the terms and conditions of 23 long-term power contracts with 14 suppliers, representing over one-half of the total value of the portfolio. These renegotiated contracts contribute to the improved fit of the portfolio to the State's forecasted demand by converting significant amounts of nondispatchable power—power that the department was obligated to purchase regardless of the need—to power deliveries the department can use when needed. In addition, the renegotiated portfolio increases power deliveries in Northern California in 2002 and 2003 to meet demand. Further, the department was able to shift some deliveries of power from Southern to Northern California, which reduced the amount of surplus power projected in Southern California. The department also renegotiated for more capacity tied to tolling agreements—

☑ *Even though the investor-owned utilities have resumed purchasing the net short, the department retains substantial responsibilities related to the long-term contracts.*

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cost management arrangements that allow the department either to purchase the fuel needed for the power facilities under contract or to tie the fuel cost to the current cost of natural gas. However, most of the improvement in the fit of the power supply to the demand has resulted from significant changes in the demand forecast rather than from significant improvements in the power contracts. These forecast changes include reductions in the demand for power from the investor-owned utilities for a variety of reasons, including the ability of certain electricity customers to buy electricity from alternate suppliers.

We recommended that the department persistently and aggressively manage the long-term contracts to capture opportunities to improve the overall supply portfolio including opportunities to further improve the match of power deliveries from the contracts to California's power needs.

***Department Action: Partial corrective action taken.***

Since the April 2003 release of our audit, the department indicates it has renegotiated three power contracts and continues to seek opportunities to renegotiate other contracts. The department indicates that the renegotiated contracts have improved the match of power deliveries to the State's needs by reducing the amount of nondispatchable power deliveries.

**Finding #2: While the renegotiation efforts will provide some savings to ratepayers, the department's portfolio still remains above market prices.**

Throughout the energy crisis, the department and the governor's office reported both the contract costs and the savings in terms of the contract payments to suppliers. Thus, they reported that the estimated reductions in contract costs from the restructuring of the contracts totaled approximately \$5.5 billion, which represents approximately 13 percent of the total original contract costs of \$42.9 billion. These contract cost reductions were based on information available at the time of the renegotiations and were calculated using a negotiation model that the department used when evaluating the effect of different renegotiation options on the reduction in contract costs.

While this savings estimate reasonably reflects reductions in the nominal cost of the contract portfolio to the department, an alternative analysis would estimate the savings to the utilities'

customers. With consideration of the replacement power costs and using the department's revenue requirement model, a department consultant estimated in March 2003 that the net savings to ratepayers in nominal terms is \$1.5 billion. Also, because these savings will occur over the next 20 years, the department consultant estimated that the net present value of the future stream of savings to ratepayers is \$580 million. These March 2003 estimates of customer savings are a function of economic, market, and dispatch assumptions used by the department consultant in its modeling and would change if those assumptions changed. Also, the department indicates that its revenue requirement model is not designed to value nonprice benefits resulting from the renegotiation efforts, such as the improved availability and reliability provisions in the contracts. Further, most of these contract cost reductions will result not from reducing the price per megawatt-hour of the power purchased but rather from shortening the length of the contracts or reducing the amount of power to be delivered. However, this reduction of contract length contributed to a department objective to shorten the time that it would have financial or legal responsibility for the contracts and, in the process, permit the utilities to procure energy themselves to meet the additional uncovered net short.

According to the department, the March 2003 estimate of savings to the consumer from the renegotiated contracts as of December 31, 2002, using its revenue requirement model, was made only at our request, and the department would not otherwise have made this calculation. In addition, the amounts are from its consultant's draft report, and had not gone through the department's ordinary standards of review. However, this is the only estimate the department provided to us of the savings to the consumer from the renegotiated portfolio as of December 31, 2002. Further, we observed that these forecasts are consistent with the forecasts prepared by the department consultant in establishing the department's revenue requirements and were also used in support of the revenue bonds that the department issued in October and November 2002.

We recommended that the department persistently and aggressively manage the long-term contracts to capture opportunities to improve the overall supply portfolio, including opportunities to achieve additional cost savings.

***Department Action: Partial corrective action taken.***

Since the April 2003 release of our audit, the department indicates it has renegotiated three power contracts and continues to seek opportunities to renegotiate other contracts. The three renegotiated contracts have reduced contract costs by approximately \$1 billion, in nominal terms. However, when considering the savings to consumers by taking into account the cost to replace the power that was eliminated through contract renegotiations, and by considering that the savings occur over time, the net present value (at 9 percent) of the total savings to customers is \$322 million. The customer savings varies between approximately \$24 million to \$74 million from year to year through 2011, but we estimated the savings at approximately \$29 million for 2003. The department's consultant calculated the total contract reductions and customer savings using market conditions at the time the three contracts were renegotiated, which is consistent with the methodology used in our audit report.

**Finding #3: The renegotiated contracts improve the reliability and flexibility of the department's energy portfolio, but challenges remain.**

Our review of the legal terms and conditions of the restructured contracts indicates that the renegotiations have generally resulted in improved terms over those in the original contracts. For example, we found that the restructured contracts have much stronger guarantees that the sellers will deliver the power promised under the contracts and build the new generation facilities promised in the contracts. As a result, the renegotiated contracts better meet the reliable energy goals of Assembly Bill 1 of the 2001–02 First Extraordinary Session (AB 1X) and thus better ensure the availability of electricity to satisfy consumer demand. These improvements are accomplished through stronger terms and conditions, such as termination rights for the State and penalty provisions when sellers fail to deliver energy or construct new generation facilities as promised under the contract. Changes in the type of energy products purchased under the contracts also increase the reliability of the department's contract portfolio. Both the stronger terms and conditions, and the product changes are likely to provide economic benefits to ratepayers. Another benefit from the renegotiations is that the State has entered into settlement

agreements with suppliers. In most of these settlements, the suppliers agreed to cooperate with the attorney general's energy investigation and to make financial settlements to the State.

While the restructured contracts are better from a legal standpoint, significant risks remain for the department, particularly in the contracts that the State has not renegotiated. An area of continuing concern is the restrictions on the department's ability to assign the contracts to other parties, particularly to the investor-owned utilities. The investor-owned utilities have resumed purchasing the net short and have also assumed the day-to-day management and operation of the contract portfolio. However, the department remains legally and financially responsible for the contracts, until either the investor-owned utilities meet certain credit standards or suppliers decide to release the department from this obligation. As a result, the department continues to have significant ongoing legal and technical responsibilities for the management of the long-term contracts and could retain those responsibilities for the remaining life of the contracts.

We recommended that the department persistently and aggressively manage the long-term contracts to capture opportunities to improve the overall supply portfolio, including opportunities to improve the terms and conditions of contracts that have not yet been renegotiated. In regard to its continuing responsibility to manage the long-term contracts, the department should monitor the performance of power suppliers relative to their contractual obligations and promptly address and resolve any supplier deviations from contractual obligations. We also recommended that the department review the appropriateness of the investor-owned utilities' proposed annual gas supply plans for contracts with tolling agreements.

***Department Action: Partial corrective action taken.***

Since the April 2003 release of our audit, the department indicates it has renegotiated three power contracts and continues to seek opportunities to renegotiate other contracts. The department reports that three contracts have improved terms and conditions. For example, one contract now includes anti-market gaming provisions and allows the department to assign it to a creditworthy investor-owned utility. Another contract also includes a settlement of claims with the attorney general and other parties, which the department indicates is valued at approximately \$1.5 billion.

To ensure that the investor-owned utilities exercise due care in the handling of the contracts, the department indicates that its staff and consultants conduct weekly internal coordination meetings as well as weekly conference calls with the investor-owned utilities. Further, the department and the investor-owned utilities work together to review the gas supply plans related to each of the gas tolling contracts. Additionally, for those contracts that are tied to new power plant construction, the department indicates that its staff and consultants witnessed 32 performance demonstration tests, which are designed to ensure compliance with contract terms either before a power plant begins commercial operation or as an annual performance test of an existing power plant. Finally, the department states that staff periodically visits construction sites for new power plants to ensure that the progress is consistent with the contract.

**Finding #4: Sales of surplus power have not significantly affected the cost of the power-purchasing program.**

In our December 2001 audit, we indicated that in future years the department's long-term contracts would likely require it to purchase more power than would be needed during some hours. Those quantities would be expected to be sold as surplus and thus have the potential to increase the overall cost of power. In 2002 the department did sell surplus power, but these sales were not significant in proportion to its total purchases. Further, our consultant advises us that the costs from the sales do not appear unreasonable. Although the department's renegotiation efforts have reduced the potential for surplus power sales in future years, it is still likely that significant sales will occur, particularly in the years 2003 through 2005.

To monitor the efforts of investor-owned utilities to limit power sales, the department should routinely collect and analyze data (including settlement data from the California Independent System Operator) on power sales by the investor-owned utilities.

***Department Action: Corrective action taken.***

The department indicates that it negotiated with the investor-owned utilities and the California Independent System Operator to receive the information needed to allow it to appropriately monitor sales of surplus energy.

**Finding #5: The department was not able to achieve coordinated dispatch of power supplies that could reduce costs.**

The department was not able to achieve a coordinated dispatch of power supplies between the contract portfolio and the investor-owned utilities' generating facilities so as to minimize costs to ratepayers. The electric power that the retail customers of the investor-owned utilities purchase is obtained from a variety of sources, each with a different cost per unit of power delivered during different times of the day and week. As such, there is an opportunity each day to optimize this mix of sources to provide power at the lowest possible cost. However, the department has been unable to implement a coordinated dispatch of power sources with the investor-owned utilities. It attributes this inability, to some degree, to the investor-owned utilities' failure to share with the department information about the availability of their generating facilities and the terms of their third-party contracts, as well as to fluctuations in demand forecasts by the investor-owned utilities that make minimizing purchase costs more difficult.

Recognizing the California Public Utilities Commission's (CPUC) established role in overseeing the dispatch decisions of the investor-owned utilities, the department should routinely monitor resource scheduling and other data provided by each utility to ensure that dispatch decisions are consistent with established operating protocols and its fiduciary responsibility to bondholders.

***Department Action: Corrective action taken.***

The department indicates that it currently receives all dispatch information on a daily basis. This information allows the department to compare actual dispatch of contract energy with projected dispatches and to determine whether there will be any significant deviations to the department's cash flow as a result of the investor-owned utilities' dispatch decisions.

**Finding #6: The department will continue to face cost and legal challenges.**

Substantial work remains to be done by others to restore California's electric markets to full health and to manage the power portfolio assembled by the department during its two-year tenure as power buyer for the State. Issues involving the creditworthiness of the investor-owned utilities must be resolved, plans must be made for the long-term governance of the utilities'

power-procurement practices, and changes are needed in the power market structure to assure that the markets are effective and well monitored. Although California's power supply situation has improved over the past two years, accounting and credit issues have affected many companies in the power supply industry, raising questions regarding the further development of new supplies. Furthermore, substantial outstanding investigations and litigation associated with the power crisis are still unresolved. In addition to marketwide issues, the department's ongoing stewardship of the Electric Power Fund and the contract portfolio will be an important component of the State's power supply for years to come. The contract portfolio is likely to remain under department management for much of the next decade and will require continued vigilance to mitigate the potentially high costs of those contracts. Attendant upon those responsibilities will be the need for the department to manage its operating partnerships with the utilities to schedule and deliver the power and to procure fuel. In addition, the department will be responsible for the administration of bonds issued to finance the cost of the AB 1X power program. These remaining responsibilities carry substantial ongoing obligations to manage costs and risks and will require a sustained professional organization at the department to properly protect the State's interests.

We recommended that the department be alert for situations in which the credit standing of the investor-owned utilities may adversely affect the department's costs. Further, the department needs to maintain the capability to analyze conditions in electricity and gas markets. The department should also use the servicing agreements with the investor-owned utilities to monitor dispatch statements from the investor-owned utilities relative to their accounting statements to the department. Finally, to fulfill its responsibilities for servicing the revenue bonds, the department should prepare revenue requirements filings for the CPUC and advise the CPUC when its regulatory oversight of the investor-owned utilities intersects with the department's responsibilities under the revenue bonds; act to mitigate risks, such as CPUC ratemaking practices, that may adversely affect bondholders; and perform financial and accounting activities necessary to support its obligations under the revenue bonds.

***Department Action: Partial corrective action taken.***

The department reports a variety of actions to address our recommendations. In regards to the credit standing of investor-owned utilities, the department notes that because gas suppliers are unwilling to extend sufficient credit to the investor-owned utilities, the department is the principal counterparty for all fuel purchasing, storage, transportation, and hedging contracts. Concerning the need to maintain capabilities to analyze conditions in the electricity and gas markets, the department subscribes to various gas and power market information services, which it uses to analyze the reasonableness of the investor-owned utilities' actions. Additionally, the department actively follows and monitors CPUC proceedings that may impact or change the operating agreements with the investor-owned utilities and that might be adverse to the department or its responsibilities under AB 1X. When such issues are identified, the department files memoranda or comments in these proceedings to preserve its rights and explain its position to the CPUC. Further, the department believes the implementation of several automated tools has allowed it to make progress in monitoring dispatch statements from the investor-owned utilities, but it indicates that some problem areas need further attention. Finally, the department indicates that it continues to prepare the annual revenue requirement for the CPUC and to perform the financial and accounting activities to support the department's obligations under the revenue bonds.



# WATER QUALITY CONTROL BOARDS

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## ***Could Improve Their Administration of Water Quality Improvement Projects Funded by Enforcement Actions***

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### **Audit Highlights . . .**

*Our review of the State Water Resources Control Board's (state board) and Regional Water Quality Control Boards' (regional boards) collection of fines and subsequent expenditure of those funds under the Porter-Cologne Water Quality Control Act (State water quality act) revealed the following:*

- As allowed by law, there is no correlation between the amount of fines collected by a given regional board and the amount the regional board receives from the state board for water quality projects.*
- From fiscal years 1998–99 through 2002–03, the regional boards collected about \$26 million in fines and the state board committed \$24.9 million for water quality projects throughout the State.*
- The state board received almost \$21 million from a legal settlement between the State and Atlantic Richfield Company and Prestige Stations, Inc., and shortly after committed \$19.2 million of those funds for water quality projects throughout the State.*

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### **REPORT NUMBER 2003-102, DECEMBER 2003**

#### **California Environmental Protection Agency response as of December 2003**

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to provide information to the Legislature and others to clarify how money designated to improve the State's water quality is distributed throughout the State. Specifically, the audit committee wanted the bureau to provide information related to the State Water Resources Control Board (state board) and a sample of Regional Water Quality Control Boards (regional boards), including how they assess and collect fines, whether they spend the fines in accordance with the Porter-Cologne Water Quality Control Act (State water quality act), and whether they spend the money they collect in or near the areas from which they collect it. The state board reports to the California Environmental Protection Agency (Cal EPA), which was created in 1991. The audit committee also asked us to identify any new funds available in the state board's operating budget and examine the ways those funds have been used. Additionally, the audit committee wanted to know the number and amount of fines the regional boards collected, the public or private entities or individuals who violate the State water quality act (polluters) most commonly, and the changes in the amount of fines assessed and collected over the last five years.

As allowed by law, there is no correlation between the amount of the fines collected by a given regional board and the amount the regional board receives from the state board. When allocating funds to regional boards, the state board attempts to determine how best to use available funds to meet the State's most urgent water quality needs. It appears reasonable that the state board would base its fund commitments not on where fines are generated but what represents the highest and best use

☑ *Despite appearing to focus on the main goal of ensuring that public and private entities comply with the State water quality act, regional boards sometimes fail to follow through on enforcement actions.*

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of those funds. From fiscal years 1998–99 through 2002–03, the regional boards collected about \$26 million in Administrative Civil Liabilities (ACL) and either spent or committed to spend \$24.9 million in water quality improvement projects.

**Finding #1: Regional boards can retain some benefits from their enforcement actions by approving supplemental environmental projects.**

Although the regional boards do not keep the money associated with the ACLs they impose locally, they can recover at least a portion of the money or otherwise retain the benefits of their enforcement actions. First, a regional board can endorse a water quality improvement project within its region and forward it for approval to the state board, which then can allocate funds to projects it considers worthy. However, not all regional boards take advantage of this option, and they may miss opportunities to realize some benefits from their enforcement actions.

Second, regional boards might benefit from their enforcement actions, in accordance with state board procedures, by seeking partial reimbursement for staff costs they incurred in enforcing the State water quality act. However, over the last five fiscal years, only five of the nine regional boards used this option to submit a total of roughly \$670,000 in claims. Also, the state board could do a better job of clearly communicating how and when regional boards may submit claims and how they can use those funds once they receive reimbursement.

Third, a regional board can retain the benefits of some of the ACLs it assesses within its region by allowing a polluter to perform or fund a supplemental environmental project (SEP) in lieu of paying a portion of an ACL. Of the four regional boards we visited, one retained benefits in lieu of almost \$3.5 million and another retained benefits in lieu of more than \$2.2 million of the ACLs they assessed in their respective regions. The four regions we visited retained more than \$6.5 million total for SEPs.

We recommended the state board encourage and assist the regional boards in taking the following steps to ensure that the regional boards receive all the funding they are entitled to under the State water quality act:

- Identify any needed water quality improvement projects in their regions and submit the appropriate funding requests to the state board.

- Collect and compile staff costs associated with enforcing the State water quality act and submit periodic claims for these costs from the account, as the State water quality act allows.
- Evaluate strategies that other regional boards use to maximize water improvement activities in their respective regions.

We also recommended the state board take steps to communicate the intent of the practice to reimburse regional boards for staff costs and the proper way to claim and use such funds to ensure that regional boards are aware of and understand how to use and subsequently spend those funds.

***State Board Action: None.***

Cal EPA stated that the state board would attempt to implement the recommendations.

**Finding #2: Regional boards do not always ensure that polluters complete supplemental environmental projects or pay fines.**

Despite appearing to focus on the main goal of ensuring that public and private entities comply with the State water quality act, regional boards sometimes fail to follow through on enforcement actions. For example, the Santa Ana and San Francisco Bay regional boards often approved SEPs for their enforcement actions but did not always ensure that the SEPs were completed. Further, all four regional boards we visited had, as state board policy allowed, suspended portions of or entire ACLs for polluters that agreed to clean up the pollution or to stop violations. However, the San Francisco Bay regional board did not always follow up to determine that polluters either came into compliance with the State water quality act in accordance with the ACL suspension agreements or paid the ACLs.

Additionally, although all the regional boards appear to collect the mandatory minimum penalties (MMPs) that they initially assessed against polluters, the San Francisco Bay and Santa Ana regional boards could assess fines more promptly when polluters continue to commit violations subject to MMPs. Regional boards that do not assess and collect fines appropriately and ensure completion of SEPs limit their ability to protect the public

health and the environment and do not ensure that violators of the State water quality act do not gain a competitive advantage over those that comply with it.

We recommended the state board require the regional boards to monitor and report on the progress and completion of these projects to ensure that the state water system receives the maximum benefit from SEPs the regional boards approve.

We also recommended the state board require the regional boards to promptly issue and collect all ACLs to ensure that the regional boards effectively use enforcement actions to discourage violations of the State water quality act.

***State Board Action. None.***

Cal EPA stated that the state board would attempt to implement the recommendations.

**Finding #3: Because the state board does not always obtain adequate information on all water quality project proposals, it cannot ensure that it funds the most meritorious projects.**

The state board's Division of Financial Assistance (division) does not consistently obtain written information regarding proposed water quality improvement projects before submitting them to the state board for review. One reason it has not consistently obtained the information is inadequate direction from the state board. Specifically, we found that in fiscal year 2002–03, for 20 water quality projects costing \$17.9 million (64 percent of the \$27.9 million funded that required state board approval), although the division followed procedures it has informally established for reviewing water quality projects, it did not follow these procedures in two cases, failing to obtain documentation on two projects worth a total of \$10 million from funds the state board received from a legal settlement. By not gathering all the necessary written information, it is not clear whether the division analyzed the merits of the two projects before submitting them for the state board to consider along with other water quality projects; thus, the state board could not make a fully informed decision regarding which water quality projects were the best use of funds. One factor limiting the division's ability to evaluate and analyze requests for water quality projects is that the state board has not formally adopted a policy to guide the division in fulfilling this responsibility. Instead, the

division has its own set of informal procedures that, lacking the authority of the state board behind them, the division is under no obligation to follow.

We recommended the members of the state board establish and approve a policy to guide division staff in processing project requests to ensure that division staff consistently review funding requests for water quality improvement projects. Further, to ensure that the state board has the information necessary to decide which of these water quality projects to fund, the division should follow the established policy in all instances.

***State Board Action. None.***

Cal EPA stated that the state board would attempt to implement the recommendations.



# SUPERIOR COURTS

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## ***The Courts Are Moving Toward a More Unified Administration; However, Diverse Service, Collection, and Accounting Systems Impede the Accurate Estimation and Equitable Distribution of Undesignated Fee Revenue***

REPORT NUMBER 2001-117, FEBRUARY 2002

Administrative Office of the Court's response as of March 2003

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### ***Audit Highlights . . .***

*Our review of certain court-related fees and the fiscal and administrative oversight of superior court operations found that:*

- The Lockyer-Isenberg Trial Court Funding Act of 1997 addressed the disposition of some fees, but did not specify who would receive others, referred to as undesignated fees.*
- Due to the decentralized nature of the superior courts' accounting and collection processes, it is prohibitively complex to determine the precise amount of revenue generated by undesignated fees.*
- We estimated that the largest division in each of the three largest superior courts together generated \$17.4 million in undesignated fee revenue during fiscal year 2000-01, most of which was distributed to the counties in accordance with locally negotiated agreements.*

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The Joint Legislative Audit Committee requested that the Bureau of State Audits review a sample of superior courts to determine how much revenue is generated by fees not designated by the Lockyer-Isenberg Trial Court Funding Act of 1997 (funding act), which entities collect these revenues, and how the courts distribute them.

### **Finding #1: The working group inappropriately categorized certain fees as undesignated.**

Although the funding act addressed the disposition of many court-related fees, it did not specify who should receive others, referred to as undesignated fees. To address this issue, a working group, comprised of representatives from selected courts and counties, was formed to recommend to the Legislature how to distribute these fees. The working group identified many fees and placed them in one of four categories. The first three categories recommended a particular distribution; however, the fourth category represented all those fees for which a recommendation could not be made. Our review of these fees found that some were in fact designated.

To ensure that all undesignated fees are properly identified and distributed, we recommended that the Administrative Office of the Courts (AOC) review and correct the working group's list of these fees.

☑ *Several issues must be resolved before the State can implement a consistent and equitable distribution of undesignated fee revenue.*

☑ *The Administrative Office of the Courts has initiated a wide-reaching management system for superior court resources; however, such actions will not ease efforts to determine how much revenue undesignated fees generate.*

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***AOC Action: Corrective action taken.***

According to the AOC, the working group's listing of undesignated fees has been reviewed and corrected.

**Finding #2: The California Constitution mandates that the entity incurring the cost in providing a service must retain the fees.**

The California Constitution imposes the restriction that any revenue generated by certain undesignated fees must be distributed to the entity that incurs the cost of providing the service. This restriction does not apply to all governmental charges, including fines or penalties; however, it does apply to fees. Before a statewide designation could be assigned for any given fee, all 58 counties would have to fund the delivery of services in the same way. Therefore, when the State considers imposing a statewide designation for a particular fee it must first consider whether it is a court or county that provides the service, which we found varies from one jurisdiction to another. Currently, the superior courts and counties have made stipulations in their local agreements for the distribution of undesignated fee revenue.

Once the working group's listing of undesignated fees has been reviewed and corrected, we recommended that the AOC:

- Direct each superior court to identify the entity in its jurisdiction that incurs the cost of providing the service related to each undesignated fee on the list.
- Direct the superior courts to ensure that, in their agreements with their respective counties, the courts distribute each of these fees to the entity incurring the cost.
- Seek legislation designating the distribution of charges other than fees, such as penalties and fines.

***AOC Action: Partial corrective action taken.***

According to the AOC, it has surveyed each superior court regarding who incurs the cost, provides the service, and retains each undesignated fee. The AOC also stated that it has proposed language concerning the appropriate distribution of undesignated fees to be included in the local agreement between each superior court and its respective

county when the agreement is renewed. The AOC also stated that it has proposed legislation to clarify the disposition of undesignated fees, fines, and penalties where currently no statutory reference provides for their distribution and use.



# VACANT POSITIONS

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## ***Departments Have Circumvented the Abolishment of Vacant Positions, and the State Needs to Continue Its Efforts to Control Vacancies***

REPORT NUMBER 2001-110, MARCH 2002

Department of Finance's response as of May 2003, State Controller's Office response as of March 2003, and Department of Mental Health's response as of November 2002

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### *Audit Highlights . . .*

*Our review of vacant positions in the State disclosed that:*

- Although the Legislature amended state law to shorten the period a position can be vacant before it is to be abolished, the law's effectiveness is hindered by departments' efforts to preserve positions.*
  - The five departments we visited misused certain personnel transactions to circumvent the abolishment of vacant positions.*
  - Changes in state law have not completely addressed the reasons departments have lengthy vacancy periods in some positions.*
  - The Department of Finance performed two reviews and plans to continue monitoring vacant positions during the next two years, but has not established an ongoing monitoring program.*
  - A method to provide the Legislature with an up-to-date yet reliable count of vacancies still does not exist.*
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The Joint Legislative Audit Committee requested the Bureau of State Audits review vacant positions in the State and the uses of funding associated with the positions. Our review found that, although the Legislature amended state law to shorten the period a position can be vacant before it is abolished, the law's effectiveness is hindered by the efforts of state departments to preserve positions. Additionally, the departments we reviewed used the funding from vacant positions to carry out their programs, in part, because certain costs have not been fully funded. Finally, the Department of Finance (Finance) performed two reviews and plans to continue monitoring vacant positions during the next two years, but has not established an ongoing monitoring program. Specifically, we found that:

### **Finding #1: The five departments we visited misused certain personnel transactions to circumvent the abolishment of vacant positions.**

The policies and procedures related to "120" transactions, which are intended to legitimately move existing employees between positions, allow flexibility, require little documentation substantiating the need for the transactions, and are not closely monitored. Although the State's policies do not specifically preclude departments from performing these transactions to avoid having positions abolished, circumventing state law is not a reasonable use of this form of transaction. Nevertheless, our review of transactions at the five departments for a two-year period revealed that they initiated at least 440 (89 percent) of 495 transactions to avoid the abolishment of vacant positions. However, our findings should not be interpreted to mean that departments throughout the State performed 89 percent

of “120” transactions to preserve vacant positions, as we selected some transactions to review because the patterns of use appeared questionable.

Our analysis of “607” transactions at these same five departments revealed that they are also sometimes being misused, though not nearly as often as “120” transactions. Properly used, “607” transactions propose new positions, delete positions, or reclassify positions. However, the departments performed, on average, at least 22 percent of the transactions we analyzed to preserve positions. More controls exist for “607” transactions than for “120” transactions, but the State requires little external accountability for “607” transactions. As we found with “120” transactions, state policies do not specifically preclude the use of “607” transactions to preserve existing positions. However, circumventing state law is not a reasonable use for the transactions.

We recommended that Finance issue an explicit policy to prohibit the use of “120” and “607” transactions to preserve vacant positions from abolishment. Additionally, we recommended that the State Controller’s Office (SCO) issue guidance to departments on processing these transactions consistent with the policy issued by Finance. Further, the SCO should periodically provide to Finance reports of such transactions. Finance should analyze the reports to identify potential misuses of the transactions and follow up with departments as appropriate. Departments should discontinue their practice of using “120” and “607” transactions to circumvent the abolishment of vacant positions.

***Legislative, Finance, and SCO Action: Legislation passed and corrective action taken.***

In September 2002 the governor approved Chapter 1124, Statutes of 2002, which amended Government Code, Section 12439, to prohibit departments from performing personnel transactions to circumvent the abolishment of vacant positions. As a result, Finance did not issue an explicit policy to prohibit the use of “120” and “607” transactions to preserve vacant positions from abolishment. In December 2002 the SCO issued guidance to departments on processing the transactions consistent with the amended statute. Further, the SCO provided reports of “120” transactions to Finance in November 2002 and March 2003, respectively, for Finance’s analysis and review. The SCO plans to provide reports of “607” transactions to Finance in fiscal year 2003–04.

Finally, the five departments we visited reported to us they have taken actions to discontinue or minimize the use of “120” and “607” transactions to circumvent state law and, thus, ensure that the transactions are used for appropriate reasons.

**Finding #2: Despite changes, state law allows some positions to remain vacant almost a year.**

After the Legislature became concerned about the number of vacant positions in state government, it amended Government Code, Section 12439, in July 2000 to reduce to six months the period of vacancy before the SCO abolishes vacant positions. However, the amended law stipulates that the six months must occur in the same fiscal year. This allows positions that become vacant after January 1 to stay vacant for almost a year before being abolished. Based on current law, the SCO’s system tracks the vacancies until June 30 and then starts recounting the six consecutive monthly pay periods on July 1. Thus, some positions could be preserved from abolishment as long as the SCO issued a payment for only two days, January 2 and December 31. Finance reported in January 2002 it plans to examine the feasibility of amending state law to allow the vacancy period to cross fiscal years. However, as Finance also reported, the SCO’s 30-year-old position control system requires significant changes to track vacancies without regard to fiscal year. Finance plans to evaluate the potential cost to modify the SCO’s system. Finance stated that if the cost is feasible, it will address the funding in spring 2002.

We recommended that Finance, in conjunction with the SCO, continue with its current plans to examine the costs associated with modifying the SCO’s position control system to track vacancies across fiscal years. If Finance determines that the necessary system changes are feasible, it should seek to amend Government Code, Section 12439, to require that the six consecutive monthly pay periods for which a position is vacant before abolishment be considered without regard to fiscal year.

***Legislative and SCO Action: Legislation passed and corrective action taken.***

Chapter 1124, Statutes of 2002, amended state law to allow the six consecutive monthly pay periods to occur within one fiscal year or between two consecutive fiscal years. As a result, the SCO has made the necessary changes to its position control system and planned to implement the changes no later than June 2003.

**Finding #3: The amended law has not resolved some of the underlying causes of vacancies.**

Changes in state law have not resolved some of the reasons departments have positions with lengthy periods of vacancy. The law currently provides departments with only one circumstance to retain vacant positions and two circumstances to reestablish vacant positions. In particular, the hard-to-fill designation has not entirely solved the problem of departments' inability to fill some vacant positions. Additionally, departments stated that lengthy examination and hiring processes hinder their ability to fill positions within six months. Further, departments may maintain some vacant positions to absorb other costs not fully funded.

We recommended that Finance continue to work with departments and other oversight agencies to fully identify and address the issues that lead to positions being vacant for lengthy periods. Finance should then consider seeking statutory changes that provide it with the authority to approve the reestablishment of vacant positions in additional circumstances, including when delays in hiring and examination processes extend the time it takes to fill positions.

***Legislative Action: Legislation passed and corrective action taken.***

Chapter 1124, Statutes of 2002, amended Government Code, Section 12439, to provide Finance with the authority to approve the reestablishment of vacant positions when certain conditions existed during all or part of the six consecutive monthly pay periods. The conditions include when a hiring freeze is in effect, when a department has been unable to fill positions despite its diligent attempts, and when positions are determined to be hard-to-fill. Additionally, the amended statute authorizes the SCO to reestablish vacant positions when department directors certify that specific circumstances existed in the six consecutive months.

**Finding #4: The SCO's system for identifying positions to be abolished cannot track a position reclassified more than once during the fiscal year and does not have the capability to account for "120" transactions performed to circumvent abolishment.**

The tracking system the SCO uses is supposed to follow a position through subsequent reclassifications. Thus, if the combined vacancy period before and after the reclassification

is more than six consecutive pay periods, the SCO flags the reclassified position for potential abolishment. However, the SCO's system for identifying positions to be abolished has two significant limitations. First, it cannot track a position that is reclassified more than once during the fiscal year. This causes the SCO to have to manually research transactions, which increases the risk that transactions may be missed. Second, the system does not have the capability to account for the use of "120" transactions performed to circumvent the abolishment of vacant positions. Our review found that departments use "120" transactions extensively to preserve vacant positions, thus increasing the likelihood of the tracking system missing vacant positions that should be abolished.

We recommended that the SCO consider the feasibility of modifying its system for identifying positions to be abolished so it can track them through more than one reclassification. Additionally, as we discussed in Finding #1, we recommended that the SCO periodically provide to Finance reports of "120" transactions so that Finance can identify potential misuses of the transactions and follow up with departments as appropriate.

***SCO Action: Corrective action taken.***

The SCO stated it has completed modifications to its system to track five different position changes. In addition, it has twice provided to Finance reports of "120" transactions for Finance's analysis of potential misuses of the transactions.

**Finding #5: The Department of Mental Health did not adhere to the established controls requiring it to seek external approval for certain "607" transactions.**

The Department of Mental Health (Mental Health) did not submit two transactions to Finance, even though they involved reclassifications to positions above the minimum salary level required for Finance's approval. Mental Health believed one of these transactions did not need Finance's approval because it downgraded a position and the related salary. Nonetheless, Finance staff stated that both transactions needed its approval.

We recommended that Mental Health ensure that it submits for Finance's required approval all "607" transactions that involve a reclassification to positions above the specified minimum salary level.

***Mental Health Action: Corrective action taken.***

Mental Health stated it has submitted for Finance’s review and approval the reclassifications involving positions above the specified minimum salary level.

**Finding #6: Despite Finance’s recent scrutiny of vacant positions, ongoing monitoring is needed.**

Finance performed two reviews to address the Legislature’s concerns about the number of vacant positions. The reviews recommended that certain departments eliminate or redirect 4,236 positions beginning in fiscal year 2000–01. Additionally, Finance recommended in its first report that the funding from the positions be reallocated to the departments for other program uses. In its second report, Finance did not identify the total amount of funding to be eliminated or reallocated. In January 2002, Finance stated that it plans to conduct further reviews in 2002 and 2003. However, no ongoing monitoring program has been established. Without a regular process to monitor vacant positions, data may not be available to enable the State’s decision makers, including the Legislature, to make informed decisions.

To ensure that the State continues to monitor vacant positions and the associated funding, we recommended that Finance direct departments to track and annually report the uses of such funding. Additionally, Finance should continue to analyze the departments’ vacant positions and uses of funds, recommend to what extent departments should eliminate vacant positions, and either eliminate or redirect the funding for the positions. Further, it should periodically report its findings to the Legislature to ensure that the information is available for informed decision making.

***Finance Action: Corrective action taken.***

Finance stated that the Budget Act of 2002, Section 31.60, directed it to abolish at least 6,000 positions from all positions in state government that were vacant on June 30, 2002. The section also authorized Finance to eliminate at least \$300 million related to the abolished positions. The section further required Finance to report to the Legislature on the specific positions abolished. Finance reported in November 2002 that it abolished 6,129 positions and \$300.4 million. However, our review of Finance’s report

revealed that it included 560 public safety positions, representing \$23.5 million in cost savings, that Section 31.60 excluded from abolishment. Additionally, we found errors that understated the abolished positions by 39 and cost savings by \$6.7 million. Moreover, we could not determine whether the positions Finance abolished included any that had been eliminated by other provisions of law. Chapter 1023, Statutes of 2002, also directs Finance to abolish at least 1,000 vacant positions by June 30, 2004, and to report to the Legislature on the specific positions abolished.

**Finding #7: Actual funding needs may be obscured because departments use funding from excess vacant positions to carry out their programs, in part, because certain costs have not been fully funded.**

Our review at five departments found that they spent the funds budgeted from excess vacant positions for the higher costs of their filled positions, overtime, personal services contracts, and operating expenses. For example, the five departments in total spent the majority of their funding from excess vacant positions on the higher cost of filled positions, in part because of their efforts to hire in hard-to-fill classifications included such expenses as hiring above the minimum salary level and pay differentials. The departments told us, and Finance acknowledges, that the State typically has not augmented department budgets for increases in the cost of filled positions. Because certain program costs have not been fully funded, departments sometimes use funding from excess vacant positions to bridge the gap between their actual costs and their present funding levels.

To ensure that budgets represent a true picture of how departments manage their programs, we recommended that Finance continue to assess if common uses of funds resulting from vacant positions represent unfunded costs that should be reevaluated and specifically funded.

***Finance Action: Corrective action taken.***

Finance stated that the Budget Act of 2002, Section 31.70, authorized it to reinstate up to one-half the funding reduced by Section 31.60 for fiscal year 2002–03 appropriations to ensure that departments have sufficient levels of funding. As of April 1, 2003, Finance approved the reinstatement of \$37.4 million in funding.

**Finding #8: A method to provide reliable, up-to-date information about the number of vacant positions does not exist.**

Legislators have expressed concerns because current point-in-time information on vacant positions from the SCO appears to show a substantially higher number of vacancies than those presented by Finance. The vacancy number that Finance presented is derived from past year actual information from other SCO reports. However, this number is generally not available until about five to six months after the end of the fiscal year. The SCO and Finance worked together to calculate a reliable, up-to-date number of vacancies as of June 30, 2001. Their efforts were beneficial as they provided a better understanding of the differences in the various data used by the entities. However, the efforts resulted in an estimate of vacancies that proved to be inaccurate.

To ensure that the State's decision makers have an accurate picture of the number of vacancies during the fiscal year, we recommended that Finance and the SCO, in consultation with the Legislature, work together on a method to calculate an up-to-date and reliable number of vacant positions statewide.



***Finance Action: None.***

Finance stated that, because of the state hiring freeze and the reductions of positions over the next several months, it would not be possible for it and the SCO to develop a method to provide up-to-date and reliable calculations of vacant positions.

# FRANCHISE TAX BOARD

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## ***Its Performance Measures Are Insufficient to Justify Requests for New Audit or Collection Program Staff***

REPORT NUMBER 2002-124, MAY 2003

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### ***Audit Highlights . . .***

***Our review of the Franchise Tax Board's (board) audit and collection activities revealed the following:***

- The board does not always describe the differing cost components of its various performance measures, potentially leading to confusion about program results.***
  - Between fiscal years 1998–99 and 2001–02, recently acquired audit staff returned \$2.71 in assessments for each \$1 of cost.***
  - Because of limitations in board data, we could not isolate the return on 175 new collection program positions.***
  - The board's process for assessing the incremental benefit of recently acquired audit and collection program positions is flawed.***
  - The board allows some collection program positions to remain unfilled in order to pay for other expenses.***
- 

### **Franchise Tax Board Response from State and Consumer Services Agency as of November 2003**

**A** primary revenue-generating agency for the State, the Franchise Tax Board (board) processes individual and corporation tax returns, audits certain tax returns for errors, and collects delinquent taxes. Between fiscal years 1990–91 and 2001–02, the board provided an average of \$31 billion in annual tax revenues to the State, over 60 percent of the State's General Fund. Although many taxes are self-assessed by individuals and companies, the board's audit program reviews the accuracy of tax returns, assessing additional taxes when appropriate. In turn, the collection program pursues delinquent taxpayers identified through the board's various assessment activities.

The Joint Legislative Audit Committee requested that we review the board's audit and collection programs, identifying recently acquired audit and collection program positions, assessing the board's calculation of the costs and benefits of these positions, and determining whether the board uses these positions as the Legislature intended. We were also asked to review the board's methodology for calculating the costs and benefits of its audit and collection programs. Finally, we were asked to determine whether a point of diminishing returns exists where additional audit and collection program positions do not generate a \$1 to \$5 cost-benefit ratio (CBR) and, if so, to determine the board's actions to shift those positions to other activities. We found that:

**Finding #1: The board uses a variety of performance measures and does not always describe their differences in public documents.**

The board uses a variety of measurements to gauge audit and collection program performance and to assign workloads to staff. Most of these measurements take into account some of the costs and related benefits for program activities, but the various measurements may include differing calculations of costs, which the board does not always fully describe in public documents. As a result, misunderstandings of the board's performance may arise. Ideally, a performance measure should compare all the benefits of a program with all the costs of producing them. However, when the board's budget documents project a return of at least \$5 in benefits, whether assessments or revenues, for each \$1 of cost for new positions, the projected return does not reflect allocated costs for departmental overhead, such as rent and utilities, and the understated costs are not disclosed. In contrast, the historical measures reported in the board's annual operations reports are calculated using full costs.

The board's performance measures for its audit and collection programs also suffer from a partial overlap in claimed benefits, another potential source of confusion about returns on costs. After 120 days, tax assessments the audit program claims as benefits become the collection program's accounts receivable, which, if collected, are also counted as benefits of the collection program.

To more completely and clearly reveal its programs' costs and benefits, the board should consider using the complete measurement of the audit program's performance that we have described in our report. This measurement compares all the benefits—the total revenues that result over time from the auditors' assessments of additional taxes—with the total costs to produce them, including the costs of collection. If it determines that its current information system cannot produce the data necessary for such a measurement, the board should consider the needs of a complete measurement when it upgrades or changes its current information system.

If the board decides not to use the complete measurement and continues to use separate performance measurements for the audit and collection programs, in budget change documents and other reports given to external decision makers, it should:

- Explicitly disclose the elements not included in the cost components of various performance measures used to assess the audit and collection programs and the effect of their absence.
- Disclose the overlap in benefits claimed by its audit and collection programs.

***Board Action: Partial corrective action taken.***

The board reports that it has developed and deployed an enterprise Activity Based Costing (ABC) tool, which provides information on the costs to perform various processes and business activities. The ABC model includes both direct and indirect processes and activities, which contribute toward the board's programs, including programs that provide revenue to the state. The ABC model enables the board to calculate the "cost" element of the CBR, but additional work is required to link the cost of the work to the revenue generated.

The board reports that its Activity Based Revenue (ABR) effort will link the cost of work to the revenue generated by adding "revenue streams" as work products. By adding the revenue stream costs to ABC, the board will be able to more completely measure program performance—that is, total cost and total benefit for programs such as audit and filing enforcement.

The board states that its ABR effort will initially use existing fiscal year 2002–03 cost and revenue stream data, and will produce test performance measures by Spring 2004. The board will evaluate the test performance measures and make recommendations for improvements for fiscal year 2003–04 data collection. Additionally, through its ABR effort, the board is evaluating the ability of its current information systems to produce the data required for a complete measurement, and will make recommendations for future consideration. The board states that the test performance measures and recommendations will be complete by June 2004.

Finally, the board reports that it has begun to provide clarification to performance measures reported to external decision makers. It states that recent documents provided to the Department of Finance (Finance) and the Legislative Analyst's Office (LAO) have both footnoted the measurement type and clarified its discount status. The board plans to continue this practice in future communications.

**Finding #2: Prospective cost-benefit ratios for individual audit types do not reflect historical performance.**

The board's historical performance measure of returns on its audit program includes the full effect of indirect costs, including departmental overhead, but the prospective CBRs for individual audit types do not. Thus, when full departmental overhead costs are taken into account, certain prospective CBRs drop below the anticipated return of \$5 in assessments generated for every \$1 of cost.

When we deflated the board's projected returns by actual departmental overhead costs, we found that had the board included full departmental overhead costs, the total actual return in assessments would closely resemble the board's projections. However, when we examined individual audit types, the variance was much greater, and the workplan projections failed to mirror historical returns. For example, the average assessment per \$1 invested in personal income tax desk audits over the period was \$3.87, whereas the board estimated that they would return \$6.36. Even after deflating the workplan projections by departmental overhead costs, actual assessments per dollar of cost were still \$1.75 less than originally projected.

The board believes that these differences generally arise from adjustments the audit program makes to historical data ultimately reported in operations reports. According to the board, the adjustments are made to correct misallocated charges and miscoded revenue and to better match costs to benefits. If the audit program corrects errors in the financial reporting system when it recalculates the basis for projections, we would expect that the board would use the corrected data in the operations reports, which it publishes after it prepares the workplans.

If the board believes that information it publishes in its operations reports is not accurate, even though it is based on the board's financial accounting system, the board should:

- Ensure that its financial accounting system reports accurate information, and
- Correct data it believes to be inaccurate before it publishes the information in its operations reports.

To track the accuracy over time of its calculations of the prospective CBRs for individual audit workload types, the board should compare these prospective CBRs against actual returns annually. The board should make the results available to Finance and the LAO and should also include them in the board's annual report to the Legislature on the results of its audit and collection activities. If the board believes this information is confidential, it can cloak the identity of the individual audit workloads in its annual report to the Legislature. Moreover, the board should use the results of the comparison in future calculations of prospective CBRs.

***Board Action: Corrective action taken.***

The board states that it is reviewing its methods of gathering data used in its operations reports and is reviewing actual costs and revenue reported. According to the board, progress has been made in changing the methods of assigning support costs for many sections beginning with fiscal year 2003–04. The board states that it is also continuing to look at the methods used to compile the operations reports.

The board further reports that it is compiling the information necessary to compare prospective CBRs against actual returns for its current workplan process and will include this information in its annual report to the Legislature. The board plans to use this information as one of several factors in its calculations of projected CBRs.

**Finding #3: The board's budget change documents do not show how new audit positions have met projected results.**

Although the board's current resource request format for new audit positions provides decision makers with more detail regarding audit workloads than the board typically provided prior to our 1999 report titled *Franchise Tax Board: Its Revenue From Audits Has Increased, but the Increase Did Not Result From Additional Time Spent Performing Audits*, its current format is still insufficient to demonstrate both the workload types to which the board intends to assign new staff and the historical return on those workloads. In addition, historical actual returns on the specific workloads are not measured against the projections used to justify the staff increases.

While the board's resource request format does include many of the features we previously recommended, it does not detail historical and projected hours and assessments by audit type as

we had suggested. Rather, the board summarizes all desk, field, and Internal Revenue Service follow-up audit activity into a single category, which obscures the very different returns on each of the personal income tax and corporation tax audit types. Without this information, decision makers are left without an accurate tool against which to measure whether the board's staffing increases return their projected assessments.

To provide useful information to decision makers when requesting additional audit positions, the board should use a format, shown in our 2003 report, that details the types of activities new auditors will perform as well as the projected assessments and historical assessments resulting from these activities. Additionally, the board should revise its supporting audit workplan to include the actual returns of each of the specific workload types for the most recently completed fiscal year.

***Board Action: Pending.***

The board states that before making any changes to its resource request format and supporting audit workplan it must first discuss them with the users of these documents. The board reports that due to the recent budget situation and the change in administration, discussions with the users of these reports have been delayed. According to the board, its budget director is scheduled to meet with Finance in November 2003 to discuss our suggested changes to these documents.

**Finding #4: The incremental benefit of new audit positions was originally negative but has increased recently and measuring the incremental benefit of additional collection program staff proves elusive.**

Although sufficiently demonstrating the overall cost-effectiveness of its audit and collection programs, the board's process for assessing the incremental benefit of recently acquired audit and collection program positions is flawed. The board uses an inadequate methodology to determine whether increases in audit assessments or collection program revenues resulted from additional positions. Rather than using an incremental approach to isolate assessment or revenue pools likely to have been affected by additional audit or collection program positions, the board compares its total projected audit assessments against its total actual audit assessments and its total projected collection program revenue against its total actual collection program revenue.

To determine the incremental benefit of the 340 net new audit positions between fiscal years 1992–93 and 2001–02, we isolated their budgeted costs and the actual assessments associated with the audits to which the board would have likely assigned the new staff. We found that the new audit positions generated average assessments of only \$0.79 for every \$1 of cost. It is important to note that the return on the additional positions shows improvement over more recent fiscal years. Between fiscal years 1998–99 and 2001–02, the new positions produced average assessments of \$2.71 for every \$1 of cost. Changes in the economy probably affected the return on these audit positions, but a significant cause of the low return is that despite having additional staff, the board did not increase the number of hours staff spent performing audits. The collection program received 175 positions between fiscal years 1998–99 and 2001–02, promising increased revenue of \$179 million over that period. However, because of limitations in board data, we could not determine the return on the collection program positions.

See the recommendation under finding #3 above for addressing the measurement of the effectiveness of additional audit positions. To better measure the effectiveness of its additional collection positions, the board should develop a methodology for determining the incremental return of new collection program positions received in any given year. This type of analysis should isolate changes over a base year in revenue pools that are affected by the new positions and compare the resulting revenue against all costs resulting from the new positions.

***Board Action: Partial corrective action taken.***

The board reports that it is well on its way towards completing the design of a more refined methodology for measuring the effectiveness of manual collection efforts. The board states that it has established a consensus across the collection program as to the definition of “proactive,” “reactive,” and “automated” collection activities. The board reports that it has also created a conceptual framework for measuring inputs in terms of time expended by direct collection and support staff and matching the results in terms of dollars collected. This new framework will allow the establishment of a base year and comparison of results from year to year. The board reports that it has populated this model, run preliminary tests, and is currently evaluating the

results of those tests. Although the board plans to implement the new methodology in January 2004, it concedes that this target date may slip partially because of budget cuts.

**Finding #5: The board's justification for new collection program positions does not reflect its current process for assigning work.**

Unlike the audit program, which both justifies new positions and assigns work based on a workplan process that prioritizes work according to a CBR, the collection program currently uses a similar workplan process only to justify its increases in collection program positions. In actually assigning work, the board relies on the recently implemented Accounts Receivable Collection System (ARCS) to rank accounts according to various risk and yield factors that predict the likelihood of collection as well as the ultimate amount the system expects to collect. According to the director of the board's special programs bureau, now that the collection program has nearly two years of collecting experience using ARCS, analysis is under way to use data from the system to justify future staffing needs.

To more accurately represent how it actually allocates resources, the collection program should continue to develop a methodology based on ARCS for justifying future collection program positions. The revised process should include all relevant costs, including an allocation for departmental overhead, in addition to the ARCS' risk and yield factors. The estimated expenditures and projected revenues related to each new staffing request should be easy to compare against actual results.

***Board Action: Partial corrective action taken.***

The board reports that the workload tracking and revenue assignment methodology discussed above will complement the process used to project potential revenue from new collection positions that may be added in the future. The board expects to have this new reporting methodology in place by January 2004.

**Finding #6: The board leaves some approved collection program positions unfilled.**

The board is not using all of its funding for collection program salaries to actually fill authorized positions, but is instead using some funding for other costs. Periodically, the board rewards employees for meritorious performance through pay increases, or merit salary adjustments (MSA), above the initial salary funding for their positions. Before fiscal year 1999–2000, the board received budget augmentations to fund its MSAs, but beginning in fiscal year 1999–2000, the board’s MSA funding ended. The difference between the total hours collection program staff worked and the total budgeted hours for the collection program increased by 5 percent shortly after the board lost its separate funding for MSAs.

Since the loss of separate MSA funding, the board has required each branch to achieve savings to pay for the branch employees’ MSAs, allowing them to realize the savings from unfilled positions. The board believes state departments must leave positions vacant or they will overspend their salaries and wage budgets. However, Government Code Section 12439 requires that positions that are continuously vacant for six months be eliminated and Finance recently began eliminating those positions in state departments.

For the board to be consistent with the intent of budget control language and Finance, it should not, as a long-term strategy, leave collection program positions unfilled beyond the normal time it takes to fill a position.

***Board Action: Corrective action taken.***

The board reports that Finance removed all vacancies in existence on June 30, 2003, but has since returned some of the positions. According to the board, a small number of vacancies currently exist, but it states that virtually every vacancy in the collection program will be filled by the end of December 2003. The board also states that it will fill any future vacancies at the earliest opportunity. Finally, the board states that any future funding requests for additional positions will be based on a realistic estimate of appointment dates for the new employees.



# FEDERAL FUNDS

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## ***The State of California Takes Advantage of Available Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource***

REPORT NUMBER 2002-123.2, AUGUST 2003

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### **Audit Highlights . . .**

*Our review of federal grant funding received by California found that:*

- California's share of nationwide grant funding, at 11.8 percent, was only slightly below its 12 percent share of the U.S. population.*
- Factors beyond the State's control, such as demographics, explain much of California's relatively low share of 10 large grants.*
- Grant formulas using out-of-date statistics reduced California's award share for another six grants.*
- In a few cases, California policies limit federal funding, but the effect on program participants may outweigh funding considerations.*
- California could increase its federal funding in some cases, but would have to spend more state funds to do so.*

*continued on next page*

### **Departments of Finance and Health Services responses as of October 2003**

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits determine whether California is maximizing the amount of federal funds it is entitled to receive for appropriation through the Budget Act. Specifically, we were asked to examine the policies, procedures, and practices state agencies use to identify and apply for federal funds. We also were asked to determine if the State is applying for and receiving the federal program funds for which it is eligible, and to identify programmatic changes to state-administered programs that could result in the receipt of additional federal funds. Finally, the audit committee asked us to examine whether the State is collecting all applicable federal funds or is forgoing or forfeiting federal funds for which it is eligible. Specifically, we found:

### **Finding #1: California's share of federal grants falls short of its population share, due in part to the State's demographics and federal grant formulas.**

California's share of total federal grants awarded during fiscal year 2001–02 was 11.8 percent, or \$42.7 billion. This share is slightly below California's 12 percent share of the nation's population (population share). For 36 of 86 grants accounting for 90 percent of total nationwide federal grant awards in fiscal year 2001–02, California's share was \$5.3 billion less than an allocation based on population share alone. Grants for which California's share falls below its population share include ones in which demographics work against California, and formula grants that provide minimum funding levels to states or use out-of-date statistics. With regard to state efforts to gain federal funding, we found that state

- ☑ *In some instances, California has lost federal funds because of its noncompliance with program guidelines or by not using funds while they are available.*
  - ☑ *The statewide hiring freeze and a pending 10 percent cut in personnel costs may further limit federal funds for staff.*
- 

departments appear to use reasonable processes to identify new or expanded funding from federal grants and do not miss grant opportunities because of a lack of awareness.

Of the 36 grants for which the State's share fell below its total population share, 10 are due to California's low share of a particular demographic group. For example, California received relatively little of the federal funds awarded to rural communities for water and waste disposal systems in fiscal year 2001–02 because its rural population is low in relation to the rest of the nation. In addition, California is the country's sixth youngest state, so it received less than its total population share of grants to serve the elderly.

Funding formulas that do not allocate funds based on populations in need result in a lower percentage of grant funding for populous states such as California. Some grants are awarded based on old statistical data that no longer reflect the distribution of populations in need. For example, much of a grant for maternal and child health services is distributed according to states' 1983 share for earlier programs, for which California's share was 5.8 percent. If the entire grant were based on more current statistics, California's award for fiscal year 2001–02 would be \$23.6 million higher. Other grants provide minimum funding to states without regard to need; the State Homeland Security grant, for example, distributes more than 40 percent of its funds to states on an equal basis, with the rest matching population share. For this grant, the average per resident share for California will be \$4.75, far less than the \$7.14 average per U.S. resident.

We recommended that as federal grants are brought up for reauthorization, the Legislature, in conjunction with the California congressional delegation, may wish to petition Congress to revise grant formulas that use out-of-date statistics to determine the share of grants awarded to the states.

***Legislative Action: Legislation passed.***

In September 2003, the Legislature passed an Assembly Joint Resolution requesting that the California congressional delegation use the opportunities provided by this year's reauthorization of several federal formula grant programs to attempt to relieve the disparity between the amount of taxes California pays to the federal government and the amount the State receives in return in the form of federal formula grants and other federal expenditures.

**Finding #2: State and local policies have limited California's share of federal funds in a few cases.**

State and local policies limit California's share of federal funds for three programs. For the Special Education–Grants to States (Special Education) grant, California's share is less than would be expected based on its number of children because of the local approach to deeming children eligible for special education services. California's federal funding for the In-Home Supportive Services program is also low because of a state program that pays legally responsible relatives to be caregivers, a type of activity that is ineligible for federal reimbursement. Another agency has proposed changing the Access for Infants and Mothers and State Children's Health Insurance (Children's Insurance) programs to increase federal grant funding. These policies have affected the State's ability to maximize the receipt of federal funds. However, we did not review the effects on stakeholders that a change in government policies for these programs would entail, effects that may outweigh funding considerations.

The State's Residual In-Home Supportive Services program, funded solely from state and county sources, has likely reduced the participation of some eligible recipients in the federally supported Personal Care Services program. Both programs provide various services to eligible aged, blind, and disabled persons who are unable to remain safely at home without this type of assistance. The Residual In-Home Supportive Services program provides additional services and serves recipients who are not eligible for the federal program. In addition, the State's program allows legally responsible relatives to be caregivers to recipients. Legally responsible relatives include spouses and parents who have a legal obligation to meet the personal care needs of their family members. The federal program, in contrast, does not allow payments to such caregivers.

The Department of Health Services (Health Services), in conjunction with the Department of Social Services, may be able to apply for a waiver under the Medical Assistance program, called Medi-Cal in California. This recently developed waiver program, called Independence Plus, may allow states to claim federal reimbursement for a portion of the expenditures for caregiver services provided by family members. The departments estimate that the State may be able to save \$133 million of costs currently borne by the State's Residual In-Home Supportive Services program if this waiver is pursued. They indicated that they are jointly exploring the feasibility of this waiver.

We recommended that Health Services continue to work with the Department of Social Services to determine the feasibility of pursuing an Independence Plus waiver that may allow the State to claim federal reimbursement for a portion of the expenditures for caregiver services provided by legally responsible family members to participants in the In-Home Supportive Services program.



***Health Services' Action: Pending.***

Health Services says that due to the state budget crisis and lack of available staff to develop the new Independence Plus waiver, it has suspended efforts in this area. When it obtains additional resources to work on the waiver, it says it will resume working with the Department of Social Services to obtain federal approval.

**Finding #3: California is not obtaining the maximum funding available from some federal grants, but to do so generally would require more state spending.**

The State has lost some federal dollars because departments were unable to obtain the matching state dollars required by federal programs. For example, a Health Services program to recognize high-quality skilled nursing facilities would have received more federal grant money had state matching funds been available. For fiscal years 2001–02 and 2002–03, the federal government agreed to provide as much as \$16 million for the program. In fact, however, Health Services received only \$4 million in state funding for this program during fiscal year 2001–02, and it received no state funding for the program in fiscal year 2002–03 because of cuts in General Fund spending. Consequently, the State received \$12 million less in federal funding than it would have if it had spent the originally planned state match.

In addition, a reduction in state funding for several transportation-related funds may lead to the loss of federal funding for local projects. For example, the Los Angeles County Metropolitan Transportation Authority reported that if it could not replace traffic fund contributions, it risked losing \$490 million in federal funds for one project. In April 2003, it requested that this project replace other projects already earmarked for funding by another state transportation fund in order to secure the federal funding. The use of state matching dollars to maximize federal funds must, however, be balanced against the State's other priorities.

We recommended that the Legislature may wish to ask departments to provide information related to the impact of federal program funding when it considers cuts in General Fund appropriations.

*Legislative Action: Unknown.*

**Finding #4: The State has lost and may continue to lose some federal funds because of an inability to obligate funds, federal sanctions, and budget constraints.**

Over the last three fiscal years, agencies sometimes lost federal funds by failing to obligate funds within the grants' period of availability. In addition, noncompliance with program guidelines in four instances resulted in funding losses of more than \$758 million, mostly related to the lack of a statewide child support automation system. Finally, the statewide hiring freeze sometimes keeps agencies from spending available federal funding on grants staff, and a pending budget cut of 10 percent in personnel costs may further limit spending of federal funds.

***Period of Availability***

The most significant loss of federal funds resulting from a failure to obligate funds within a grant's period of availability relates to the Children's Insurance program grant, which is administered by the Managed Risk Medical Insurance Board (board). According to the board, over the last three years the State has forgone as much as \$1.45 billion in available federal funding because of a slow start-up and limited state matching funds. As a state initiating a new program, California's need to enroll clients led to a slow start-up of the Children's Insurance program and a resulting loss of federal funds, which primarily match a state's spending on insurance coverage for enrollees. According to a report by San Diego State University, administrative start-up costs made up a high proportion of total costs for states with new Children's Insurance programs, but the federal Children's Insurance program limits federal funding for these costs to 10 percent of total program costs. Thus, states with new programs had to bear most of the costs for outreach and other administrative expenditures during this phase.

California has not had enough qualified program expenditures to use its total annual allocations each year, but expenditures have been rising steadily. According to estimates by the board, reimbursable program expenditures will approximate its annual

allocations in the next few years. Thus, the board estimates that unspent grant funds that carry over from year to year, though still large, will decline, and reversions to the federal government will stop after October 2003.

### ***Program Noncompliance***

Noncompliance with program guidelines in four instances resulted in funding losses of more than \$758 million, mostly related to the lack of a statewide child support automation system. Since 1999, California has paid federal penalties for failing to implement a statewide child support automation system. Through July 2003, the total amount of federal penalties paid by the State amounted to nearly \$562 million. The estimated penalty payment for fiscal year 2003–04 is \$207 million.

As a step toward eliminating the penalties, the Legislature enacted Chapter 479, Statutes of 1999, providing guidelines for procuring, developing, implementing, and maintaining a single, statewide system to support all 58 counties and comply with all federal certification requirements. In June 2003, the Department of Child Support Services and the Franchise Tax Board, which is managing the project, submitted a proposal to the Legislature to enter into a contract with an information technology company to begin the first phase of project development in July 2003, with implementation in the 58 counties completed by September 2008. The total 10-year project cost is \$1.3 billion, of which \$801 million is for the contract. The federal government has conditionally approved the project, which is estimated to be eligible for 66 percent federal funding.

### ***Hiring Freeze and Proposed 10 Percent Staff Reduction***

In order to address the State's significant decline in revenues, Governor Gray Davis has undertaken several initiatives to reduce spending on personnel. These include a hiring freeze in effect since October 2001 and a 10 percent reduction in staffing proposed in April 2003. The hiring freeze already has had a negative effect on some federal programs, and the 10 percent reduction may affect them as well. After the October 2001 executive order, the Department of Finance (Finance) directed agencies, departments, and other state entities to enforce the hiring freeze. It also established a process for exempting some positions. The process includes explaining why a particular

position should be exempted and what the effect of not granting an exemption would be. Departments and their oversight agencies must approve the exemptions and then forward them to Finance for approval.

In response to our audit survey, staff at two departments said the hiring freeze and an inability to obtain exemptions had affected their federal programs negatively. In September 2002, the U.S. Centers for Disease Control and Prevention (CDC) wrote to Health Services noting vacant positions within the State's National Cancer Prevention and Control program and difficulties in filling vacancies due to the state-imposed hiring freeze as a major weakness. In a December 2002 letter of response to the CDC, Health Services indicated that it had filled some vacant positions, and in March 2003 Health Services sent exception requests for five federally funded positions to Finance, four of which Finance denied. As of June 2003, Health Services said that the CDC planned to reduce its grant for the 12 months ending June 30, 2004, to \$8.4 million from the \$10.6 million awarded for the nine months ending June 30, 2003. Health Services said an important element in the CDC's reduction was Health Services' inability to fill vacant federally funded positions.

Similarly, the U.S. Department of Agriculture (USDA) informed the Department of Education's (Education) Nutrition Services Division in September 2002 that through a management evaluation it had identified corrective actions in several areas where a lack or shortage of staff contributed to findings. It was concerned about staffing shortages in a unit responsible for conducting reviews and providing technical assistance to sponsoring institutions participating in the child nutrition programs. It warned that the USDA may withhold some or all of the federal funds allocated to Education if it determines that Education is seriously deficient in the administration of any program for which state administrative funds are provided. In May 2003, the State Superintendent of Public Instruction wrote to the Governor's Office asking for approval of a blanket freeze exemption allowing Education to fill all division vacancies, reestablish 12 division positions eliminated during the fiscal year 2002-03 reduction of positions, and exempt the division from a proposed 10 percent reduction in staff.

We recommended that Finance ensure that it considers the loss of federal funding before implementing personnel reductions related to departments' 10 percent reduction plans.

***Finance Action: Partial corrective action taken.***

Control Section 4.10 of the 2003 Budget Act, approved by Governor Gray Davis in August 2003, requires the Director of Finance to reduce departments' budgets by almost \$1.1 billion and abolish 16,000 positions. Finance states that it specifically omitted any federal funds from its August 2003 notice to the Legislature identifying the appropriations to be reduced in accordance with this section. It did this so that departments would not be required to reduce federal fund appropriations without full consideration of the effects.

# STATE MANDATES

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## ***The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process***

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### *Audit Highlights . . .*

*Our review of the Peace Officers Procedural Bill of Rights (peace officer rights) and the animal adoption mandates found that:*

- The costs for both mandates are significantly higher than what the Legislature expected.*
- The local entities we reviewed claimed costs under the peace officer rights mandate for activities that far exceed the Commission on State Mandates' (Commission) intent.*
- The local entities we reviewed lacked adequate supporting documentation for most of the costs claimed under the peace officer rights mandate and some of the costs claimed under the animal adoption mandate.*
- Structural reforms are needed to afford the State Controller's Office an opportunity to perform a field review of initial claims for new mandates early enough to identify potential problems.*
- Commission staff have indicated that the Commission will not be able to meet the statutory deadlines related to the mandate process for the foreseeable future due to an increase in caseload and a decrease in staffing.*

### **REPORT NUMBER 2003-106, OCTOBER 2003**

#### **Commission on State Mandates' and State Controller's Office's responses as of December 2003<sup>1</sup>**

The Joint Legislative Audit Committee asked the Bureau of State Audits to review California's state mandate process and local entity claims submitted under the Peace Officers Procedural Bill of Rights (peace officer rights) and animal adoption mandates. Our review found that the costs for both mandates are significantly higher than what the Legislature initially expected. In addition, we found that the local entities we reviewed claimed costs under the peace officer rights mandate for activities that far exceeded the Commission on State Mandates' (Commission) intent. Further, claimants under both mandates lacked adequate supporting documentation and made errors in calculating costs claimed.

The problems we identified highlight the need for some structural reforms of the mandate process. Specifically, the mandate process does not afford the State Controller's Office (Controller) the opportunity to perform a field review of the first set of claims for new mandates early enough to identify potential claiming problems. In addition, the Commission could improve its reporting of statewide cost estimates to the Legislature by disclosing limitations and assumptions related to the claims data it uses to develop the estimates. Finally, Commission staff have indicated that the Commission will not be able to meet the statutory deadlines related to the mandate process for the foreseeable future due to an increase in caseload and cutbacks in staffing. Specifically, we found:

#### **Finding #1: Local entities claimed reimbursement for questionable activities under the peace officer rights mandate.**

We question a large portion of the costs claimed by four local entities that received \$31 million of the \$50 million paid under the peace officer rights mandate, and we are concerned that

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<sup>1</sup> City of Los Angeles, San Francisco, San Jose, Los Angeles County, and San Diego County responses as of January 2004.

the State already may have paid more than some local entities are entitled to receive. In particular, we question \$16.2 million of the \$19.1 million in direct costs that four local entities claimed under the peace officer rights mandate for fiscal year 2001–02 because they included activities that far exceed the Commission’s intent. Although we noted limited circumstances in which the Commission’s guidance could have been enhanced, the primary factor contributing to this condition was that local entities and their consultants broadly interpreted the Commission’s guidance to claim reimbursement for large portions of their disciplinary processes, which the Commission clearly did not intend. We also noted that the local entities we reviewed did not appear to look at the statement of decision or the formal administrative record surrounding the adoption of the statement of decision for guidance when they developed their claims.

We recommended that, to ensure local entities have prepared reimbursement claims for the peace officer rights mandate that are consistent with the Commission’s intent, the Controller audit the claims already paid, paying particular attention to the types of problems described in our report. If deemed appropriate based on the results of its audit, the Controller should request that the Commission amend the parameters and guidelines to address any concerns identified, amend its claiming instructions, and require local entities to adjust claims already filed. The Controller should seek any statutory changes needed to accomplish the identified amendments and to ensure that such amendments can be applied retroactively.

We also recommended that, to assist local entities in preparing mandate reimbursement claims, the Commission include language in its parameters and guidelines to notify claimants and the relevant state entities that the statement of decision is legally binding on all parties and provides the legal and factual basis for the parameters and guidelines; it also should point out that the support for such legal and factual findings is found in the administrative record of the test claim.

Further, we recommended that all local entities that have filed, or plan to file, claims for reimbursement under the peace officer rights mandate consider carefully the issues raised in our report to ensure that they submit claims that are for reimbursable activities. Additionally, they should refile claims when appropriate. Finally, if local entities identify activities

they believe are reimbursable but are not in the parameters and guidelines, they should request that the Commission consider amending the parameters and guidelines to include them.

***Controller Action: Partial corrective action taken.***

The Controller reports that it has developed an audit program and initiated audits of the peace officer rights claims. In addition, the Controller indicates that it has met with Commission staff regarding a legislative proposal to allow retroactive claiming when amendments are made to reduce existing parameters and guidelines.

***Commission Action: Corrective action taken.***

Commission staff report that they have developed language to implement our recommendation for inclusion in all new parameters and guidelines adopted on or after December 3, 2003.

***Local Entities Action: Pending.***

The city of Los Angeles reports that it is working with its consultant and the Controller to clarify what activities are subject to reimbursement. It will then take appropriate action based on that information. Los Angeles County reports that it is revising its fiscal year 2002–03 peace officer rights claim in light of our audit findings and the Controller’s draft claiming instructions for conducting time studies. However, its 60-day response did not address revisions to claims it submitted for earlier years. The city and county of San Francisco (San Francisco) disagrees with our findings related to the peace officer rights mandate and believes that the activities it claimed are allowable because it considers them to be an integral part of investigation activities related to the peace officer rights process and reasonable and necessary to protect its peace officers’ rights in these cases. Finally, although the city of Stockton (Stockton) indicated in its initial response to our report that it generally agrees with our recommendations and plans to file amended claims, it did not provide us a 60-day response to update its status.



**Finding #2: In varying degrees, claimants under the peace officer rights and animal adoption mandates lacked adequate support for their costs and inaccurately calculated claimed costs.**

We questioned \$18.5 million of the \$19.1 million in direct costs that four local entities claimed under the peace officer rights mandate because of inadequate supporting documentation.

The local entities based the amount of time they claimed on interviews and informal estimates developed after the related activities were performed instead of recording the actual staff time spent on reimbursable activities or developing an estimate based on an acceptable time study.

Additionally, we noted several errors in calculations of costs claimed under the peace officer rights mandate. Although we generally focused on fiscal year 2001–02 claims, the largest error we noted was in the fiscal year 2000–01 claim of one local entity. It overstated indirect costs by about \$3.7 million because it used an inflated rate and applied the rate to the wrong set of costs in determining the amount it claimed. We noted two other errors related to fiscal year 2001–02 claims involving employee salary calculations and claiming costs for processing cases that included those of civilian employees, resulting in a total overstatement of \$377,000.

We also found problems with the animal adoption claims. The four local entities we reviewed could not adequately support \$979,000 of the \$5.4 million they claimed for fiscal year 2001–02. In some instances, this lack of support related to the amount of staff time spent on activities. In another instance, a local entity could not adequately separate the reimbursable and nonreimbursable costs it incurred under a contract with a nonprofit organization that provided shelter and medical services for the city’s animals.

In addition, we noted numerous errors in calculations the four local entities performed to determine the costs they claimed under the animal adoption mandate for fiscal year 2001–02. Although these errors caused both understatements and overstatements, the four claims were overstated by a net total of about \$675,000. Several errors resulted from using the wrong numbers in various calculations involving animal census data.

We recommended that the Controller issue guidance on what constitutes an acceptable time study for estimating the amount of time employees spend on reimbursable activities and under what circumstances local entities can use time studies.

We also recommended that all local entities that have filed, or plan to file, claims for reimbursement under the peace officer rights or animal adoption mandate consider carefully the issues raised in our report to ensure that they submit claims that are supported properly. Additionally, they should refile claims when appropriate.

***Controller Action: Partial corrective action taken.***

The Controller indicates that it has been meeting with representatives of local governments and local government organizations to review proposed time study guidelines.

***Local Entities Action: Partial corrective action taken.***

Five of the six local entities we reviewed provided us a 60-day response generally indicating that they had taken some action to correct errors and develop better documentation to support their claims. In particular, the cities of Los Angeles and San Jose and San Diego County indicated that they either have or plan to submit revised animal adoption claims for fiscal year 2001–02. In addition, the city of Los Angeles indicates that it corrected some errors in its peace officer rights claiming process, and San Francisco reports that it is working on developing and enhancing support for its peace officer rights claim. Further, Los Angeles County reports that it is revising its fiscal year 2002–03 peace officer rights claim in light of our audit findings and the Controller’s draft claiming instructions for conducting time studies. However, none of the 60-day responses mentioned whether or not the entities plan to submit revised peace officer rights claims for fiscal year 2001–02. Finally, although Stockton indicated in its initial response to our report that it generally agrees with our recommendations and plans to file amended claims, it did not provide us a 60-day response to update its status.

**Finding #3: The Commission’s animal adoption guidance does not adequately require claimants to isolate reimbursable costs for acquiring space and its definition of average daily census could be clearer.**

Although the guidance related to the animal adoption mandate generally is adequate, the Commission’s formula for determining the reimbursable amount of the costs of new facilities does not isolate how much of a claimant’s construction costs relate to holding animals for a longer period of time. The two local entities we audited that claimed costs for acquiring space in fiscal year 2001–02 used the current formula appropriately to prorate their construction costs. However, one of them needed space beyond that created by the mandate; as a result, the costs it claimed probably are higher than needed to comply with the mandate.

In addition, we found that one local entity understated its annual census of dogs and cats by including only strays in the figure, instead of including *all* dogs and cats. The entity made

this mistake because it used a definition from an earlier section of the parameters and guidelines that limited the census number to strays. Although the parameters and guidelines could have been clearer by including a separate definition in the care of dogs and cats section of the guidance, we believe the context makes it clear that the total costs for *all* dogs and cats must be divided by a census figure including *all* dogs and cats to compute an accurate daily cost per dog or cat.

We recommended that the Legislature direct the Commission to amend the parameters and guidelines of the animal adoption mandate to correct the formula for determining the reimbursable portion of acquiring additional shelter space. If the Commission amends these parameters and guidelines, the Controller should amend its claiming instructions accordingly and require local entities to amend claims already filed.

In addition, we recommended that the Controller amend the claiming instructions or seek an amendment to the parameters and guidelines to emphasize that average daily census must be based on all animals housed to calculate reimbursable costs properly under the care and maintenance section of the parameters and guidelines.

***Legislative Action: Legislation proposed.***

The Legislature has introduced Assembly Bill 533, which would direct the Commission to amend the parameters and guidelines of the animal adoption mandate to correct the problem we identified. As of January 2004, the bill was being discussed in assembly committees.

***Controller Action: Pending.***

Although the Controller indicates in its 60-day response that it has met with Commission staff and Joint Legislative Audit Committee (JLAC) staff regarding legislative proposals to address our recommendations, the response did not specifically address our recommendation related to care and maintenance costs under the animal adoption mandate.

**Finding #4: Structural reforms are needed to identify mandate costs more accurately and to ensure that claims reimbursement guidance is consistent with legislative and commission intent.**

The problems we identified related to claims filed under the peace officer rights and animal adoption mandates highlight the need for some structural reforms of the mandate process. For example, it is difficult to gauge the clarity of the Commission's guidance and the accuracy of costs claimed for new mandates until claims are subjected to some level of field review. However, the mandate process does not afford the Controller an opportunity to perform a field review of the claims for new mandates early enough to identify potential claiming problems.

Also, inherent limitations in the process the Commission uses to develop statewide cost estimates for new mandates result in underestimates of mandate costs. Even though Commission staff base statewide cost estimates for mandates on the initial claims local entities submit to the Controller, these entities are allowed to submit late or amended claims long after the Commission adopts its estimate. The Commission could disclose this limitation in the statewide cost estimates it reports to the Legislature by stating what assumptions were made regarding the claims data. In addition, Commission staff did not adjust for some anomalies in the claims data they used to develop the cost estimate for the animal adoption mandate that resulted in an even lower estimate.

We recommended that the Controller perform a field review of initial reimbursement claims for selected new mandates to identify potential claiming errors and to ensure that costs claimed are consistent with legislative and Commission intent. In addition, the Commission should work with the Controller, other affected state agencies, and interested parties to implement appropriate changes to the regulations governing the mandate process, allowing the Controller sufficient time to perform these field reviews and identify any inappropriate claiming as well as to suggest any needed changes to the parameters and guidelines before the development of the statewide cost estimate and the payment of claims. If the Commission and the Controller find they cannot accomplish these changes through the regulatory process, they should seek appropriate statutory changes.

We also recommended that Commission staff analyze more carefully the completeness of the initial claims data used to develop statewide cost estimates and adjust the estimates accordingly. Additionally, the Commission should disclose the incomplete nature of the initial claims data when reporting to the Legislature.

***Controller Action: Pending.***

The Controller reports that it has met with Commission staff regarding a legislative proposal to change the statewide cost estimate process and make other structural reforms. The Controller also indicates that it has met with JLAC staff on proposed legislation for implementing several of our recommendations.

***Commission Action: Partial corrective action taken.***

Commission staff indicate that they have met with the Controller and plan to meet with other state agencies and interested parties to discuss implementation of our recommendations. In addition, staff report that they will seek regulatory or statutory changes as necessary based on these discussions. Further, Commission staff indicate that they have developed additional assumptions and revised the method for projecting future-year costs and for reporting statewide cost estimates to the Legislature.

**Finding #5: Commission staff assert that lack of staffing will continue to affect the Commission's ability to meet statutory deadlines related to the mandate process.**

Commission staff indicated that the Commission has developed a significant caseload and has experienced cutbacks in staffing because of the State's fiscal problems. As a result, staff state that the Commission will not be able to meet the statutory deadlines related to the mandate process for the foreseeable future. This will cause further delays in the mandate process in general, including determination of the potential cost of new mandates.

We recommended that the Commission continue to assess its caseload and work with the Department of Finance and the Legislature to obtain sufficient staffing to ensure that it is able to meet its statutory deadlines in the future.

***Commission Action: Corrective action taken.***

Commission staff report that, on an ongoing basis, they will submit budget change proposals to the Department of Finance for additional resources that support the Commission's caseload. In addition, staff will report caseload status to the Commission at each hearing and to relevant legislative committees upon request.



# CALIFORNIA DEPARTMENT OF EDUCATION

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## ***The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them***

REPORT NUMBER 2003-107, NOVEMBER 2003

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### *Audit Highlights . . .*

*Our review of the State's process for identifying, assessing, and overseeing education-related categorical programs concludes that:*

- The California Department of Education (CDE) did not take sufficient steps to implement a pilot project aimed at reforming categorical programs.*
  - CDE's allocation of categorical program funding needs improvement. Specifically, for three of the 12 categorical programs reviewed, CDE may not have accurately calculated allocation amounts in accordance with state law.*
  - CDE has yet to implement fully the Bureau of State Audits' previous recommendations aimed at strengthening its oversight methods.*
  - For a few categorical programs, such as the Lottery Education Fund program, CDE does nothing to review recipient's compliance with applicable requirements.*
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### California Department of Education response as of January 2004

The Joint Legislative Audit Committee directed the Bureau of State Audits (bureau) to review the State's process for identifying, assessing, and overseeing categorical programs. Our report concluded that the extensive number and breadth of categorical programs challenges the State's ability to reform and oversee them. For purposes of our audit, we defined "categorical funding" broadly so that we could identify allocations made by the California Department of Education (CDE) and the State Controller's Office (SCO) for programs providing funding over and above the basic funding provided to local education agencies (LEAs), typically referred to as revenue limit funding. Categorical funding is far-reaching. For fiscal year 2001–02, CDE and the SCO disbursed roughly \$17 billion to various recipients for 113 categorical programs. In addition, for five of these categorical programs, the State delayed CDE's authority to allocate funding totaling \$867 million until fiscal year 2002–03. We reported the following issues:

#### **Finding #1: CDE could not demonstrate sufficient efforts to implement a pilot project giving flexibility to categorical program funding.**

Chapter 369, Statutes of 2000, enacted in September 2000, required CDE to establish the Pilot Project for Categorical Education Program Flexibility (pilot project). Participating school districts would have flexibility in spending categorical funds among 24 programs within three clusters: (1) school improvement and staff development, (2) alternative and compensatory education, and (3) school district improvement. Only five school districts actually applied to participate in the pilot. However, CDE did not take sufficient steps to fully implement the project, failing to follow recommendations of the

project's advisory group and of state law. Having abandoned the pilot project, the State has lost valuable information to guide its reform of categorical programming.

To implement the pilot project as state law requires, we recommended that CDE provide direction to those school districts currently participating in the pilot project on how to capture and report information necessary to determine their pupils' academic progress. We also recommended that CDE report to the governor and the Legislature on the pilot project's status. Finally, we recommended that CDE survey nonparticipating school districts to assess their level of interest in the pilot project. If the survey results indicate a high level of interest, CDE should distribute its streamlined application packet to school districts. However, if the survey results indicate a low level of interest, CDE should consider seeking legislation to eliminate the provisions of Chapter 369, Statutes of 2000.

***CDE Action: Pending.***

CDE stated that it contacted each of the five districts that participated in the original pilot project. CDE sent a survey asking each district to summarize its activities, experiences, and recommendations concerning the pilot project. CDE stated that as of January 2004 it had received a completed survey from one district. Further, CDE stated that once all five districts respond to the survey, it will summarize the survey results and include them in a report to the governor and the Legislature. CDE also stated that it would include in the report the results from state assessments to determine whether the students in the participating districts benefited from the funding flexibility. Also, the rates of improvement in student test scores for the periods before and after the pilot project's implementation would be compared, along with additional analyses. Finally, CDE stated that it will develop and distribute a survey to nonparticipating school districts. Distribution options include incorporating questions into the categorical program application process, sending surveys to school districts, conducting a survey via the Internet, and conducting telephone surveys of school districts.

**Finding #2: The State can learn from the federal government's previous attempts to implement block grants.**

The U.S. Congress has demonstrated a strong interest in consolidating narrowly defined categorical grant programs for specific purposes into block grants for broader purposes. In the Omnibus Budget Reconciliation Act of 1981, Congress created nine block grants from about 50 of the 534 categorical programs in effect at that time. When Congress requested a report on federal block grant programs, the U.S. General Accounting Office (GAO) identified lessons learned from implementing federal block grant programs—lessons the State should consider in any categorical reform efforts it undertakes.

Across government services, the GAO has recommended a shift in focus of federal management and accountability toward program results and outcomes, with less emphasis on inputs and rigid adherence to rules. This focus on outcomes is particularly appropriate for block grants, given their emphasis on providing states the flexibility to determine the specific problems they want to address and the strategies they plan to employ.

The GAO also suggested that funding allocations based on formulas that target funds most effectively consider the following three variables: (1) state or local need, (2) differences among states in the costs of providing services, and (3) state or local ability to contribute to program costs. To the extent possible, equitable allocation formulas should rely on current and accurate data that measure need and ability to contribute.

We recommended that when the Legislature considers future reform proposals calling for the consolidation of categorical programs into block grants, it should ensure that proposals contain: accountability provisions that include a focus toward program results and outcomes; and allocation methods that reflect the recipient's need, ability to contribute to program costs, and cost of providing services.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

**Finding #3: Efforts to reform categorical programs should also consider the impact of constitutional and legal requirements.**

Our legal counsel observes that federal law, federal and state constitutional principles, and court decisions may affect certain categorical programs. Thus, any decision to create block grants must consider any legal restraints on consolidating programs. For example, the State receives federal money under numerous federal programs. Federal law generally restricts states to using those funds for the purposes of the federal programs; and under some federal programs, each state must provide matching funds as a condition of receiving federal money. Consequently, reform efforts in California should carefully consider whether categorical programs involving federal funds are appropriate candidates for consolidation into block grants and whether moving state funds that support those federal programs into block grants would affect the State's eligibility for federal funds.

Reformers should also consider the impact of state constitutional principles on proposed block grants. The two landmark decisions of *Serrano v. Priest* required the State to remedy disparities in per-pupil spending between school districts but excluded spending on categorical programs for special needs from the requirement that funding be roughly equal across districts. In *Butt v. State of California*, the California Supreme Court held that the California Constitution makes public education a uniquely fundamental concern of the State and prohibits the maintenance and operation of the public school system in a way that denies basic educational equality to students of particular districts. Further, the court held that the State bears the ultimate responsibility to ensure that the public school system provides basic equality of educational opportunity. Therefore, any reform efforts should include mechanisms by which the State can ensure that block grants are distributed, administered, and overseen in a manner that fulfills this constitutional obligation.

Moreover, funding for categorical programs created by an initiative measure approved by the voters, such as the California Lottery Act of 1984, may be used only for the purposes that voters approved. For example, the California Lottery Act limits the use of funds to the education of students and expressly prohibits lottery funds from being spent for acquisition of real property, construction of facilities, financing of research, or any other noninstructional purpose. Under the California Constitution, the voters must approve any changes to the

purposes for which those funds may be spent. Thus, if money from the Lottery Education Fund is consolidated into block grants, either the State must continue to spend it for the purposes specified in the act or reformers must obtain the voters' approval to expand or change those purposes.

In other instances, court decisions affect specific categorical programs. For example, the California Supreme Court, in *Crawford v. Board of Education*, held that school boards have an obligation under the California Constitution to take reasonably feasible steps, in addition to desegregation obligations under federal law, to alleviate racial segregation in public schools. Thus, school districts will be required to continue to fund that constitutional obligation from some revenue source.

We recommended that when the Legislature considers future reform proposals calling for the consolidation of categorical programs into block grants, it should determine whether categorical programs involving federal programs are appropriate candidates for consolidation. Further, the Legislature should consider whether the reform proposal (1) is consistent with any legal restrictions that may apply to any particular funds and the State's constitutional obligation to provide equal educational opportunities within the public school system and (2) includes mechanisms by which the State can monitor and ensure that it meets those obligations. Finally, the Legislature should determine whether state or federal court decisions govern the funding of particular programs and ensure that block grant proposals continue to meet those mandates.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing these recommendations.

**Finding #4: Inconsistencies or errors exist in CDE's calculations for four categorical programs.**

The Targeted Instructional Improvement Grant (TIIG) program combines funding to certain LEAs for their court-ordered desegregation and voluntary integration programs. LEAs include school districts, charter schools; county offices of education; special education local plan areas; regional occupational centers or programs; the State's three diagnostic centers; and in a few instances, joint powers authorities.

To calculate recipients' allocations, state law requires CDE to use both the LEA's actual average daily attendance (ADA) as reported on the apportionment for the period covering July through April and its total ADA. But state law does not define the term "total" ADA. CDE did not include the adult education ADA when calculating the fiscal year 2001–02 allocations for TIIG. Because state law does not define "total" ADA, it is unclear whether CDE's exclusion of adult ADA is appropriate. Our recalculation, including adult education ADA, of the allocations for three of the five LEAs tested found that Los Angeles Unified, San Bernardino City Unified, and Fresno Unified would have been increased by \$3.9 million, almost \$36,000, and \$29,000, respectively. This exclusion of adult ADA had no effect on the other two districts because one did not have adult ADA data and the other received the minimum amount set by state law.

We recommended that if the Legislature concurs with CDE's exclusion of adult ADA when making allocations for the TIIG program, it should enact language to clarify its definition of "total" ADA.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

The California Public School Library Act program provides funds for resources such as books, periodicals, computer software, CD-ROMs, and equipment enabling school library and on-line access. State law requires CDE to calculate allocations by using regular ADA reported for the period covering July through April of the prior fiscal year. However, state law does not specifically define the term "regular" ADA. In the absence of a definition, CDE defines "regular" ADA for this program as the regular elementary and high school ADA. CDE uses a different definition when calculating the apportionment for the period covering July through December. Specifically, staff responsible for this task define regular ADA as regular elementary and high school ADA plus extended-year ADA. Applying CDE's different definitions of regular ADA to our recalculation of the allocations for six LEAs results in different allocation amounts for some districts. For example, using the definition CDE applies to the principal apportionment, our recalculation of the allocations for certain LEAs under the California Public School Library Act program results in \$30,000 more for one LEA and \$665 less for another.

We recommended that if the Legislature desires CDE to properly calculate allocations the way the Legislature intends, it should define “regular” ADA for the California Public School Library Act program.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

The School Improvement Programs funds school site councils’ plans to improve instruction, services, and school environment. CDE’s allocation method appears inconsistent with a literal reading of the statutory allocation formula found in state law. Currently, the School Improvement Programs are sunsetted by other provisions of state law, yet the Legislature continued to fund it in the annual budget act. Our legal counsel has advised us that CDE is required to comply generally with the purposes of the program and to continue allocating funds under the sunset statutory allocation formula.

State law specifies how CDE is to determine whether schools with Kindergarten through grade six (K-6) should receive a cost-of-living adjustment (COLA). Our review of CDE’s calculation found that CDE has been multiplying the predetermined rate of \$106 by the annual COLA percentage instead of the same percentage increase made in base revenue limits for unified school districts with more than 1,500 ADA. The Legislature’s intent in enacting Education Code, Section 52048(a) (b), was to simplify and equalize the funding system for schools with K-6. Because CDE could not provide us with the percentage increase data for the unified school districts for fiscal years 1985–86 through 2000–01, we are unable to compute the overall effect that this apparent inconsistency has on meeting the Legislature’s intent.

We recommended that if the Legislature continues to fund the School Improvement Programs in the annual budget and intends that CDE make adjustments to equalize the funding for schools with K-6 using the same percentage increase made in base revenue limits for unified school districts with more than 1,500 ADA, it should enact language that provides CDE with specific instructions on how to compute the percentage increase.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

The Miller-Unruh Basic Reading Act program (Miller-Unruh) provides a school district an allowance for the salary of reading specialists, computed by multiplying the number of reading specialists the district employs by the statewide average salary for such a position. Districts must use their funds to pay for any difference between the allowance and the teachers' actual salaries. On June 30, 1987, Miller-Unruh was sunsetted by provisions of state law, yet the Legislature continued to fund it in the annual budget act.

State law allows CDE to adopt an allocation method but has requirements for prioritizing new Miller-Unruh funds. In calculating the number of reading specialists to allocate to applicants, CDE did not follow a 1999 state law requiring the use of Academic Performance Index (API) data to define underperforming schools and did not follow the requirement of the 2001 Budget Act to consider the financial ability of those districts with the lowest base revenue limit amounts. Instead, CDE relied only on factors such as mean reading scores below 565 on the Stanford 9 tests, the number of previously authorized reading specialists, and the number of elementary schools within a district. Moreover, although CDE calculated its fiscal year 2002–03 allocation using applicants' base revenue limit amounts, it still did not use their API data. As a result, for fiscal years 2001–02 and 2002–03, those school districts with underperforming schools or the lowest base revenue limits may not have received first priority for the reading specialist positions. The State did not appropriate funds for Miller-Unruh for fiscal year 2003–04.

CDE also failed to adhere to state law regarding the reallocation of unused reading specialist positions. For fiscal year 2001–02, LEAs reported to CDE that they did not use 66 Miller-Unruh reading specialist positions. However, in fiscal year 2002–03, CDE did not reallocate 54 of these unused positions, allowing 28 LEAs to retain them. Further, CDE's billing data for fiscal year 2001–02 indicates that eight of the 28 LEAs that did not even participate in Miller-Unruh continued to receive allocations in fiscal year 2002–03 for 9.5 positions. Because CDE did not follow state law to reallocate unused reading specialist positions, some districts that could have used the specialists went without them.

We recommended that if the Legislature continues to fund the Miller-Unruh Basic Reading Act program in the annual budget, it should ensure that CDE allocates Miller-Unruh reading specialist positions in a manner that gives first priority to school districts with underperforming schools and the lowest base revenue limits. Further, it should ensure that CDE reallocates unused positions in the following fiscal year.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing these recommendations.

**Finding #5: CDE has yet to implement fully the bureau's previous recommendations aimed at strengthening its oversight methods.**

CDE's oversight methods are similar to those it had in place when the bureau conducted its last audit of CDE's monitoring efforts. In January 2000 the bureau issued a report titled *Department of Education: Its Monitoring Efforts Give Limited Assurance That It Properly Administers State and Federal Programs*. The bureau found that CDE staff did not review fund recipients based on their risk for noncompliance, did not routinely use performance measures to assess quality and effectiveness, did not conduct the number of required program reviews, and did little to ensure that organizations took corrective actions or faced sanctions when CDE discovered deficiencies. The bureau recommended that CDE make several changes in its oversight of state and federal programs, for example, establish performance measures, direct staff to adhere to audit and review cycles, monitor LEAs' corrective action, and enforce fiscal and administrative penalties as needed. Yet CDE has not taken action on some of the bureau's recommendations, citing budget cuts as the cause. Consequently, CDE lacks assurance that recipients are properly spending the funds that these categorical programs provided.

We asked CDE to provide us with its current progress and planned action for implementing 15 of the bureau's recommendations from the January 2000 report. According to CDE, it fully implemented eight recommendations, partially implemented three, and is evaluating and reconsidering the remaining four. Our review of CDE's efforts showed that it did not always identify current progress and planned actions for all of its monitoring divisions and did not always specifically

address its implementation of the bureau's recommendations. For example, in our prior report the bureau recommended that CDE modify its underlying philosophy for administering state and federal programs to restore its accountability for monitoring entities receiving federal funds. However, even though in September 2003 CDE stated that it will revise the coordinated compliance review (CCR) monitoring process for fiscal year 2004–05, it is silent as to how it will modify its underlying philosophy for other monitoring divisions administering state and federal programs. In addition, the bureau recommended that CDE prepare a department-wide monitoring plan that includes, at a minimum, various elements such as monitoring goals and identifying mandated monitoring requirements. In its one-year response to our January 2000 report, CDE stated that it convened an external advisory committee to discuss the redesign of its monitoring and accountability system. However, CDE does not describe the results of the committee meeting in its September 2003 discussion on current progress and does not address how it has prepared a department-wide monitoring plan. The bureau also recommended that CDE direct all program reviewers to adequately document the monitoring procedures performed during site visits. CDE told us that it plans to develop a checklist for every program compliance area in the CCR process; reviewers will check "yes" or "no" to demonstrate whether they have reviewed the required documentation. However, because the proposed checklist will not require CCR reviewers to document exactly what they examine during site visits, the checklist may hinder a supervisor's ability to ensure that the CCR reviewer examined all required items. Finally, the bureau recommended that CDE establish a monitoring committee composed of various representatives such as executive management, audits division, CCR reviewers, and individual program reviewers. In its September 2003 discussion of its planned action for implementing the recommendation, CDE does not state whether it will establish a monitoring committee. Rather, CDE states that the CCR reviewers meet with CDE program staff to refocus the CCR monitoring process and that its Audits and Investigations Unit periodically meets with and distributes reports to the Nutrition Services and Child Development divisions as well as the Adult Education Office to discuss their monitoring efforts.

We recommended that CDE continue to implement the bureau's January 2000 recommendations aimed at strengthening CDE's oversight.

***CDE Action: Pending.***

CDE stated that ongoing budget deliberations are likely to have a substantial effect on categorical programs. As such, CDE will address the bureau's recommendations accordingly and consider programmatic changes as necessary. Further, CDE will consider the resources needed to address changes in monitoring requirements.

Regarding CCRs, CDE stated that its CCR Management Unit will implement a process to follow-up with LEAs not submitting proposed resolution of findings by the required 45-day timeframe. CDE states that its program consultants will contact those LEAs that have not submitted their proposed resolutions to determine the reason for delay and to provide technical assistance if needed.

**Finding #6: CDE provides no assurance that funds are spent properly for two categorical programs totaling \$1.8 billion.**

For the TIIG program and the Lottery Education Fund, CDE provides no assurance that funds are spent properly. CDE stated that discussions with legislative staff led it to believe that TIIG was purposely kept ambiguous to allow previous participants greater flexibility in spending funds and using the funds to embark on new programmatic areas. Thus, in February 2002 CDE informed county and district superintendents of schools and district business officials that there would be no application process, claim audit, reporting requirements, or program plans for TIIG. Further, CDE points out that the second priority of TIIG—to provide instructional improvement for the “lowest-achieving pupils in the district”—would be almost impossible to monitor because state law does not define this term. CDE believes that legislative staff are fully aware that there is little reason for oversight given such broad terms. CDE also points out that the Legislature did not intend to establish fiscal oversight because the new law deletes previous audit requirements. Specifically, previous state law for the desegregation programs under court mandate required LEAs to submit a claim for reimbursement to the SCO for the costs of the program. The claims were subject to the audit and approval of the SCO prior to payment to ensure that the LEA was complying with state law. However, current state law creating TIIG makes no mention of SCO or CDE oversight.

We recommended that if the Legislature intends CDE to provide oversight for TIIG, it should enact language specifically requiring CDE to do so. It should also enact language to define the term “lowest-achieving pupils in the district.”

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing these recommendations.

The California Lottery Act of 1984 limits the use of lottery funds to the education of students and expressly prohibits lottery funds from being spent for acquisition of real property, construction of facilities, financing of research, or any other noninstructional purpose. Under the California Constitution, the voters must approve any changes to the purposes for which lottery funds may be spent. For example, Proposition 20 restricts a small portion of the lottery funds for the purchase of instructional materials.

Control Section 24.60(b) of the 2001 Budget Act requires CDE to conduct a survey of a representative sample of 100 LEAs to determine patterns of use of lottery funds in those agencies and report the survey results to the Legislature and the governor. Yet CDE merely collects and reports the expenditure data and does not review expenditures to ensure that LEAs did not spend them for the acquisition of real property, construction of facilities, financing or research, or any other noninstructional purpose. According to CDE, it plans to propose changes to the *Standards and Procedures for Audits of California K-12 Local Education Agencies (K-12 Audit Guide)*, which the SCO issues to assist certified public accountants and public accountants to determine whether these funds were being spent in compliance with the law. Nevertheless, these efforts will not be sufficient to ensure that lottery funds are not spent on acquisitions that state law expressly prohibits.

We recommended that CDE continue its plan to propose changes to the *K-12 Audit Guide* to determine whether Proposition 20 funds are being spent in compliance with state law. Additionally, it should propose a similar change to the *K-12 Audit Guide* to ensure that funds are not being spent for the acquisition of real property, construction of facilities, financing of research, or any other noninstructional purpose.

***CDE Action: Pending.***

CDE stated that on November 4, 2003, the SCO's Audit Committee agreed to revise the K-12 Audit Guide to include CDE's proposed steps for determining whether Proposition 20 funds are being spent in compliance with state law. CDE also stated that the proposed K-12 Audit Guide will be sent to the Education Audit Appeals Panel for adoption into regulations.



Further, CDE stated that it proposed a change to the K-12 Audit Guide to determine whether lottery funds are being spent for the acquisition of real property, construction of facilities, or financing of research. However, CDE states that it will not propose audit procedures to determine whether lottery funds are being spent for "non-instructional purposes" unless the term is defined in statute.



# CALIFORNIA NATIONAL GUARD

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## ***To Better Respond to State Emergencies and Disasters, It Can Improve Its Aviation Maintenance and Its Processes of Preparing for and Assessing State Missions***

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### *Audit Highlights . . .*

*The California National Guard (Guard) can improve its aviation maintenance and its process to prepare for and assess state missions:*

- The Army Guard's ability to perform state missions may be compromised by a shortage of qualified aircraft mechanics and delays in receiving helicopter parts.*
- The Army Guard does not ensure that personnel readiness reports exclude ineligible troops; however, because the Office of Emergency Services typically does not request full troop strength, the Army Guard's personnel readiness has no bearing on its ability to assist the State.*
- The Guard needs to make certain that personnel in its Joint Operations Center who coordinate the Guard's state mission response receive requisite training.*
- The Guard does not annually review and update its various emergency plans nor ensure that it implements recommendations from past mission assessments.*

REPORT NUMBER 2001-111.2, FEBRUARY 2002

California National Guard's response as of February 2003

The Joint Legislative Audit Committee requested that the Bureau of State Audits review the California National Guard's (Guard) readiness to respond to a natural disaster, civil disturbance, armed conflict, or other emergency. However, many of the Unit Status Report (USR) records on federal readiness are not available, being classified by the U.S. Army. Similarly, the U.S. Air Force has determined that all its Status of Resources and Training System readiness data are classified. Consequently, we are unable to report on the Army Guard's or Air Guard's overall readiness ratings for their personnel, equipment on hand, equipment condition, and training. Therefore, we focused much of our audit on the missions the Guard performs at the State's request. We especially considered the three Army Guard units most frequently called up and how the percentages of grounded helicopters might affect their ability to assist in state emergencies. We also looked at how personnel readiness, as reported in the USRs, might affect use of the Army Guard for federal wartime duty.

### **Finding #1: A lack of staff formally trained in helicopter maintenance and delays in receiving helicopter parts may contribute to low numbers of operational aircraft.**

U.S. Army regulations instruct the Army Guard commanders to attain aircraft readiness goals by effectively managing maintenance and part supplies. However, data reported in the monthly Bridge Commanders' Statements do not identify reasons for delays in the helicopters receiving either maintenance or parts—specifically, whether delays are caused by personnel levels or some other factor. In their USRs submitted between January 2000 and July 2001, two of the three units we studied reported shortages of qualified aircraft mechanics. Our review of the units' manning reports—which identify all the

units' personnel and their assigned duties and formal training—showed that 50 percent of two units' maintenance staff were not formally trained in maintenance of UH-60 helicopters. It seems reasonable to conclude that the low numbers of operational aircraft are influenced by a lack of trained aircraft mechanics.

Generally, the U.S. Army trains the Guard's aircraft maintenance mechanics but cannot accommodate all new Guard recruits in the training courses. Therefore, the Army Guard must recruit aircraft mechanics with maintenance training on other types of helicopters and provide transition training to do maintenance on its UH-60s or CH-47s. However, these mechanics may not be able to work without supervision or sign off on major maintenance items. Further, because of increased time spent training and supervising personnel without formal training, the Army Guard's qualified staff may have fewer hours to spend meeting maintenance demands.

In addition, the Army Guard indicated that a lack of replacement parts is a barrier to keeping its helicopters operational. The Army Guard attributes this to the U.S. Army's choice to not use its resources for the requisite amount of aircraft replacement parts. As a result, there are simply not enough parts in inventory to meet demand.

To help improve its percentage of operational aircraft, the Guard should improve its data tracking and collection to determine why helicopters are not operational, then take appropriate steps to correct the identified deficiencies. In addition, the Guard should reassess the feasibility of distance learning opportunities for its maintenance personnel, including those previously coordinated with the U.S. Army, until the U.S. Army makes more training slots available for new recruits.

***Guard Action: Partial corrective action taken.***

The Guard reports that it has taken certain actions such as forming an aviation readiness council; having its aviation directorate closely monitor monthly aircraft readiness reports to allocate resources to non-operational aircraft; and implementing a program for quick assessment of aircraft readiness, focusing on non-mission capable aircraft, their available date, and critical problems. In addition, the Guard told us that the U.S. Army is improving the availability of aircraft parts to help improve the Guard's readiness. With regard to distance learning, the Guard noted that the

necessary hardware is already available in various Guard locations and it will pursue the acquisition of distance courses when the National Guard Bureau develops them.

**Finding #2: The Army Guard's use of full-time maintenance personnel to fight wildfires delays helicopter maintenance.**

The Guard's practice of using its full-time helicopter maintenance staff as crew to drop water on California wildfires delays maintenance and contributes to the lack of operational helicopters. For example, in 2000, the Army Guard flew its helicopters on 13 separate fire-fighting missions between July 26 and September 5 and dropped at least 2.4 million gallons of water. We analyzed the Guard's pay records, and found that full-time maintenance facility staff from two units contributed about 65 percent of their unit's total man-days during the 2000 fire season.

The Guard should determine how frequently it uses its full-time flight facility personnel in fire-fighting missions and set a standard that will not negatively affect the Army Guard's ability to meet helicopter maintenance demands.

***Guard Action: Corrective action taken.***

The Guard reports that it completed an analysis of its 2000 fire fighting season payroll records for various flight personnel. The Guard stated that its data show that part-time guard personnel are engaged in its fire fighting efforts. The Guard said it has established a standard that will keep the percentage of full-time and part-time fire fighting personnel commensurate with the percentage of these same personnel at its aviation facilities.

**Finding #3: Weaknesses in the Army Guard's process for reporting personnel could result in overstated personnel readiness.**

Contrasted with the aviation capability for state missions, the Army Guard's personnel readiness affects only the federal need for troops. In a quarterly USR, each Army Guard unit reports its personnel status by comparing available strength levels, or staffing, against wartime requirements. However, the Army Guard lacks an effective process to ensure that a unit includes only eligible soldiers in its strength levels. For example, the three Army Guard units we reviewed erroneously included at least 21 soldiers in their

combined USRs. Therefore, these units may have overstated their personnel strength levels, or P-levels, making it appear as though they are more ready for war or other federal duties than they are.

To validate the accuracy of USR data, we expected the Army Guard's headquarters would have a process that includes at least a comparison of soldiers pending discharge and inactive soldiers to those reported in the units' USRs and a review of soldiers listed in the "nonvalidate pay report" it receives from the National Guard Bureau (NGB)—a report that identifies part-time soldiers who have not received pay for 90 consecutive days. Because the personnel office maintains such data, it could use these records to ensure that units accurately compute their P-levels. However, the personnel office does not validate the accuracy of USR personnel data for all units, so the Army Guard's headquarters cannot ensure that units are preparing their P-levels accurately.

According to the director of the personnel office, headquarters does not instruct the units, such as those in the 40<sup>th</sup> Infantry Division (40<sup>th</sup> ID) to work with the personnel office during the USR process. Consequently, the Army Guard's headquarters is relying solely on the 40<sup>th</sup> ID to accurately compute its P-levels. The 40<sup>th</sup> ID represents 52 percent of the total units the Army Guard reports to the U.S. Army and 74 percent of the Army Guard's personnel.

To strengthen its process for personnel reporting in the USR, the Army Guard should do the following:

- Instruct the 40<sup>th</sup> ID and the personnel office to work together during the USR process to ensure that units in the 40<sup>th</sup> ID report accurate personnel data.
- Train appropriate staff on how to complete the USR.
- Strengthen its USR validation procedures to ensure that units adhere to U.S. Army regulations when they report USR data.

***Guard Action: Corrective action taken.***

The Guard stated that it has, on two separate occasions, instructed both the 40<sup>th</sup> ID and 49<sup>th</sup> CSC, that the personnel office would validate key personnel data. In addition, in April and July 2002, the Guard trained its field command personnel on the proper procedures for completing the USR—emphasizing the problems and submission standards for non-deployable personnel. The

Guard also reported that during its April and July 2002 USR data collection and preparation, it reviewed the accuracy of personnel data using seven different personnel reports.

**Finding #4: Flaws in the personnel office’s database prevent the Guard from detecting all discharged soldiers units report on their USRs.**

Even if the personnel office performed a more thorough review, its database contains flaws that prevent it from detecting all discharged soldiers on the USR. In our attempt to calculate the average time it takes the personnel office to process discharges, the Guard gave us two lists that we found to contain inaccurate data. First, the personnel office gave us a list of soldiers from our selected units processed for discharge in 2001. However, the Guard later informed us that six soldiers on the list were still active members of the Army Guard. Because of the errors we identified, we requested and the personnel office sent us another list. However, again we found incorrect information for some soldiers on the list, such as the Guard’s officers and warrant officers. Until it corrects serious database deficiencies, the personnel office will not be able to detect all discharges that units report on their USRs.

The Army Guard should correct deficiencies in its discharge database and continually update this database to make sure that it reflects soldiers who have actually been discharged.

***Guard Action: Corrective action taken.***

The Guard told us that it is no longer using a secondary personnel database, which contained errors to generate its reports. It claims that the primary personnel database at its headquarters is free from deficiencies and inaccuracies and it uses this database to generate reports showing discharged soldiers.

**Finding #5: Weaknesses in the Joint Operations Center’s procedures may limit its ability to provide the most effective state mission response.**

As part of Plans, Operations, and Security located at the Guard’s state headquarters, the operations center manages the Guard’s state missions. The operations center provides in-house staff training on its operating procedures and a brief overview

of the Response Information Management System, an Internet-based system used by local and state agencies to manage the State's response to disasters and emergencies. However, the operations center does not track who has attended its in-house training or require its staff to complete other disaster preparedness training. Further, the operations center's premission monitoring of potential and ongoing disasters, which allows the Guard to anticipate the general requirements of potential state missions, is not included in its Standard Operating Procedures manual (SOP manual). Because the operations center cannot ensure that all appropriate personnel have received training or are aware of standard premission activities, staff may work less efficiently and be less prepared to act during emergencies.

The Guard should do the following:

- Develop a system to continually identify requisite training for its operations center staff.
- Ensure that staff receive the requisite training in military support to civil authorities, thereby improving staff response to state missions.
- Establish and maintain a system to track the training activities that operations center staff attend.
- Include premission activities in the operations center's SOP manual.

***Guard Action: Corrective action taken.***

The Guard reported that Plans and Operations has developed a training chart, which is used to identify and track requisite training for staff. In addition, the director of Plans and Operations is producing a monthly newsletter to help keep staff abreast of current operations, including available training. Finally, the Guard noted that it added premission activities to its SOP manual in March 2002.

**Finding #6: The Guard lacks a process to annually review and update its emergency plans.**

The Guard's emergency plans guide its response to disasters such as fires, floods, and earthquakes. Although the NGB requires the Guard to review and update these plans annually by

September 30, the Guard does not have a process to ensure that this takes place. In fact, the Guard revised only 3 of its 13 plans in calendar year 2001. The director of Plans, Operations, and Security points to high staff turnover and vacancies as reasons for the delays. Without ensuring the revisions are completed, however, the Guard cannot guarantee that its plans contain up-to-date and effective responses to disasters.

The Guard should develop and implement a system to review and update its state emergency plans annually, as the NGB requires. In addition, the Guard should review all its state emergency plans by June 30, 2002.

***Guard Action: Corrective action taken.***

The Guard reported that it has developed a system showing the month and year it reviews and/or updates a plan and when it forwards the plan to the NGB. Moreover, the Guard told us that it reviewed all its state emergency plans and made any necessary changes as of July 2002. Further, the Guard states that it prepared and published a multi-hazard plan including annexes addressing specific hazards comparable to the plans used by the Governor's Office of Emergency Services.

**Finding #7: The Guard does not have a process to implement recommendations from assessment reports.**

We reviewed After Action Reports (AARs) relating to various types of large-scale state emergencies, such as the 1992 Los Angeles riots, the 1994 Northridge earthquake, and various flood and wildfire seasons. After completing each mission, the operations center performed a formal assessment of the Guard's performance and typically identified problems and made recommendations on how the Guard could improve its state mission response. Specifically, the AARs for three missions between 1996 and 1998 indicate that at the start of each mission, the Guard should work with the Office of Emergency Services to negotiate an exit strategy that includes clearly defined criteria for extracting the Guard from a mission. NGB regulations require the Guard to terminate its military support to civil authorities as soon as possible after civil authorities can handle the emergency. Without establishing an exit strategy at the start of each mission, the Guard's crews could remain active longer than necessary, performing tasks that other entities could be doing.

Also, in three AARs submitted between 1993 and 1997, we identified a recurring problem with the Guard's ability to easily track and update the status of critical equipment. However, the Guard did not implement corrective action until early 2001, nearly eight years after it first identified the problem, when the operations center developed a list of the equipment used in state missions and began tracking that equipment's availability through monthly reports other Guard directorates prepared.

Because the Guard has no formal process to address previous problems encountered during its missions, it cannot promptly implement corrective action on AAR recommendations. The Guard acknowledges it lacks an adequate system to benefit from the previous missions' lessons. It is currently conducting a study, expected to be ready by June 2002, to identify better tracking systems for all its actions and activities, including this area.

The Guard should update the operations center's SOP manual to ensure that staff establish an exit strategy at the start of each mission. In addition, the Guard should establish a process to track and implement corrective action as appropriate on AAR recommendations, ensuring quick action to correct previous mistakes. Finally, the Guard should make sure that it completes its study by June 2002 so that it can identify better tracking systems for all of its actions and activities.

***Guard Action: Corrective action taken.***

The Guard commented that it updated its SOP manual to include establishing an exit strategy at the start of each mission. The Guard stated that it plans to carry out its exit strategies by coordinating with the Office of Emergency Services and monitoring daily situation reports during state emergencies. The Guard stated that it also updated its SOP manual to require tracking of AAR recommendations. Finally, the Guard reported that it completed its management study in June 2002, and as of March 2003, it had purchased a computerized tracking system. The Guard expects the system to be in place and fully integrated by July 2003.

# ENTERPRISE LICENSING AGREEMENT

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## ***The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars***

REPORT NUMBER 2001-128, APRIL 2002

Department of General Services and Department of Finance's responses as of April 2003<sup>1</sup>

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### *Audit Highlights . . .*

*On May 31, 2001, the State entered into a six-year enterprise licensing agreement (ELA), a contract worth almost \$95 million, to authorize up to 270,000 state employees to use Oracle database software and to provide maintenance support.*

*Our audit of this acquisition revealed the following:*

- By broadly licensing software, a buyer that has many users, such as the State, can achieve significant volume discounts.*
- The State proceeded with the ELA even though a survey of departments disclosed limited demand for Oracle products.*
- The departments of General Services, Information Technology, and Finance approved the ELA without validating Logicon's cost savings projections; unfortunately, these projections proved to be significantly overstated.*
- Logicon apparently stands to receive more than \$28 million as a result of the ELA.*

*continued on next page*

The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits (bureau) to examine the State's contracting practices in entering into the enterprise licensing agreement (ELA) with Oracle. Specifically, the bureau was asked to review the sole-source justification for the ELA and the roles of the Department of General Services (General Services), the Department of Information Technology (DOIT), and the Department of Finance (Finance) in developing and executing the ELA. We were also asked to review the terms of the agreement and determine whether they were in the best interests of the State and assess the methods used to justify the technical and business need for the ELA.

Further, we were asked to identify the fixed and variable costs of the ELA, the funding sources that will pay for it, and the reasonableness of the projected savings from the ELA. Lastly, the audit committee requested we obtain a legal opinion on whether the contract is null and void if it was executed in violation of state law.

### **Finding #1: Surveys conducted by DOIT and Finance indicated a limited need for Oracle database licenses.**

The three departments involved in the ELA—DOIT, General Services, and Finance failed to conduct a comprehensive analysis to gauge or confirm the level of statewide interest in the ELA. However, at least two months before the ELA was executed, DOIT ignored preliminary survey data that strongly suggested most departments had no immediate need for Oracle database licenses. Specifically, of the 127 surveys it sent to state entities,

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<sup>1</sup> The Department of Information Technology was sunset on July 1, 2002.

- ☑ *Nearly 10 months after the ELA was approved, no state departments had acquired the new licenses, which may be due to the fact that General Services had not issued instructions to departments on how to do so.*
  - ☑ *General Services used an inexperienced negotiating team and limited the involvement of legal counsel in the ELA contract. As a result, many contract terms and conditions necessary to protect the State are vague or missing.*
  - ☑ *Our legal consultant has advised us that a court might conclude that the ELA contract with Oracle is not enforceable as a valid state contract because it may not fall within an exception to the State's competitive bidding requirements.*
- 

DOIT received only 21 responses, five of which indicated a possible interest in purchasing any additional Oracle products under a consolidated agreement in the near future.

In November 2001, five months after the ELA was approved, Finance sent out another survey to assess the need for Oracle database licensure and to establish a basis for allocating the cost of the ELA. This survey explicitly required all departments to respond. Preliminary survey results indicated that for the 12 state departments with the largest number of authorized positions, 11 use Oracle database products to some extent. However, while the ELA will cover up to 270,000 users—more than the total number of state employees—according to the survey, 113,000 of the authorized positions at just these 11 state departments will not use the Oracle database software.

Finance administered the survey as a preliminary step to appropriately allocate the ELA's cost among the various departments, and the information obtained on current and planned use of the Oracle enterprise database licensure was to be used to develop a cost allocation model. However, as of April 2002, 10 months after the ELA was approved, the analysis of the survey was incomplete. Furthermore, state departments have not been informed of how to acquire the database licenses using the ELA. Thus, it is not surprising that no state department had acquired new licenses under the ELA as of the end of March 2002.

Finance's survey was to provide necessary information about whether state departments have purchased any Oracle database licenses or entered into any maintenance contracts since the ELA was signed. The absence of an allocation model along with the lack of any specific pricing information or ordering instructions informing departments how to purchase the database licenses through the agreement may further reduce any cost savings or utility from the ELA. In reviewing the preliminary results of the November 2001 survey, we identified 12 state departments that have entered into their own maintenance contracts with Oracle—totaling \$1.1 million for products covered by the ELA—since it was signed on May 31, 2001.

In order to take full advantage of the Oracle ELA, we recommended that Finance complete its survey and develop a method to allocate the ELA's cost to departments.

***Finance Action: None.***

Finance has elected not to complete its survey since the ELA was rescinded in July 2002.

**Finding #2: DOIT and Finance did not adequately evaluate the ELA proposal's merits.**

The State negotiated and ultimately approved the ELA proposal without sufficient technical guidance, assessment of need, or verification of projected benefits. According to officials at DOIT, General Services, and Finance, the State had never before considered a statewide software purchase, nor did it have any specific guidance in identifying the extent of the need for the software and in negotiating the key provisions to include in the contract. In fact, DOIT had looked at the concept of statewide software licensing as early as June 2000, when it hired Logicon Inc. (Logicon) to research and present information on enterprise licensing. Nevertheless, DOIT and Finance routinely evaluate IT proposals, including those involving software purchases. Although both possessed the expertise needed to evaluate aspects of the ELA proposal—DOIT the need to license 270,000 users and Finance the cost projections—neither did so, citing a lack of suitable procedures and inadequate time. To its credit, Finance's Technology Investment Review Unit (TIRU) identified specific concerns with the ELA proposal, and on May 10, 2001, communicated these concerns to the directors of Finance and DOIT. It also recommended that the proposal be postponed until the following year, giving the State a chance to develop appropriate policy. However, TIRU's concerns and recommendation were not heeded. As a result, the State committed almost \$95 million without knowing whether the costs and benefits of the ELA were justified.

Before pursuing any future enterprise agreements, we recommended the State take the following actions:

- DOIT, Finance, and General Services should seek legislation establishing the authority to enter into an ELA that protects the State's interests and clarifies each department's respective role and responsibility in the process.
- Finance should notify the Legislature at least 30 days in advance of any state department executing any future ELA.

- DOIT should continue its efforts to create a statewide IT inventory, including software.

***Finance, General Services, and DOIT Action: Partial corrective action taken.***

Finance, General Services, and DOIT developed a draft process for statewide software licenses that defined specific roles and responsibilities for the three departments and addressed analytical and approval procedures. However, because of the closing of DOIT and the adoption of Section 11.10 of the Budget Act of 2002, the process was not formally approved.

As proposed by the governor, Section 11.10 of the Budget Act of 2002 was adopted and will fulfill some of the recommendations. Specifically, Section 11.10 requires a 30-day legislative notification before any department can enter into a statewide software license agreement of \$1 million or more, regardless of future costs or savings. Additionally, the agreement must be reviewed by Finance. This section also states that any department considering entering into such an agreement is required to submit to Finance a business plan with specific components, including an analysis of base and current usage of the license, rationale for statewide license versus an alternative type of agreement, cost-benefit analysis, and funding plan.

DOIT ceased to exist on July 1, 2002, thereby ending its efforts to create a statewide IT inventory. Currently, no other state department has been assigned the responsibility to continue these efforts.

**Finding #3: The Oracle ELA could cost the State added millions in taxpayer resources.**

The Oracle ELA could cost the State \$41 million more in database license and maintenance support than what the two would have cost in the absence of the contract. This is because the State did not validate the projections of costs and savings prepared by Logicon, who, acting in an undisclosed capacity as an Oracle reseller or licensing agent, would benefit significantly from the contract. Logicon, whose only role according to the contract was as the designated lender, and who apparently stood to make more than \$28 million as a result of the ELA, developed the business case analysis General Services used to justify the State's decision to contract with Oracle. However, Logicon's analysis, which projected a savings to the State of \$111 million over

10 years, was seriously flawed. Specifically, it was based on costs that should have been excluded because they were outside the ELA's coverage or did not follow the analysis' stated methodology. Further, Logicon's calculations contained numerous errors and many of its assumptions were questionable.

To ensure that future enterprise agreements meet the State's best interests, we recommended DOIT and Finance develop policies and procedures on how to evaluate future ELAs. To be effective, one state department needs to take responsibility for developing and justifying the ELA proposal.

***Finance, General Services, and DOIT Action: Corrective action taken.***

Finance, General Services, and DOIT developed a draft process for statewide software licenses that defined specific roles and responsibilities for the three departments and addressed analytical and approval procedures. However, because of the closing of DOIT and the adoption of Section 11.10 of the Budget Act of 2002, the process was not formally approved. Further, information technology experts have informed Finance and General Services that ELAs are not generally considered a best practice, especially with state governments. These experts state that such an environment is better suited to a volume purchase agreement (VPA). According to Finance, in the event that a VPA is being considered, General Services has agreed to take lead responsibility.

**Finding #4: The State did little to protect itself against risks associated with the contract.**

The State rushed into the Oracle ELA without negotiating strong provisions to guard against the risks inherent in long-term software contracts. The term of these types of contracts generally ranges between three to five years, partly because of the rapidly changing nature of the software industry. However, the State's contract with Oracle was for six years with a maintenance option for four more years. Our technical consultant observed that by entering into such a large long-term contract, the State increased risks such as the following:

- The vendor going out of business, being purchased, or otherwise becoming unable to perform.
- Technology changes that leave the State with a prepaid, long-term contract for a product that has diminishing value.

- Future software upgrades that are not supported under the contract.
- Lack of funding to make all future payments required under the contract.
- Demand for the software licenses not meeting expectations.

To protect against such risks, buyers normally try to negotiate mitigating safeguards as part of the terms and conditions of a contract. For example, a buyer would normally want to ensure that contract terms clearly define the support level the vendor will provide, including how upgrades and subsequent versions of the software will be furnished at no additional cost. Unfortunately, the State's hastily negotiated contract with Oracle lacked adequate provisions to minimize these risks.

The increased risks associated with this long-term contract largely occurred because General Services failed to properly prepare for contract negotiations with Oracle. For example, General Services did not include on its negotiating team anyone with expertise in the area of software licensing agreements or anyone with an in-depth knowledge of Oracle's past business practices. Moreover, General Services' legal counsel's role in the negotiations was limited to a few hours review of the contract's terms and conditions occurring the day before and the day it was signed. Consequently, the contract does not adequately protect the State's interests.

We recommended that, before negotiating any future enterprise licensing agreements, General Services should assemble a negotiating team that possesses all the types of expertise necessary to protect the State's interests. Further, if deemed enforceable, General Services should renegotiate the contract to ensure it includes adequate protections for the State. We also recommended that the Legislature should consider requiring all IT contracts over a specified dollar amount to receive a legal review by General Services.

***General Services' Action: Partial corrective action taken.***

On July 23, 2002, the ELA for Oracle database licenses and maintenance support was rescinded. However, General Services stated that it would ensure sufficient resources and expertise are assigned to any future ELA proposals. If deemed necessary, this will include the use of an independent third party to review each proposed agreement. Additionally,

General Services is working on developing and delivering a comprehensive training and certification program for state contracting and purchasing officials.

In support of recommendations made on August 30, 2002, by the Governor's Task Force (task force) on Contracting and Procurement Review, an assessment was performed to determine the knowledge, skills, and abilities needed by acquisition professionals. This information was used to determine course content for a comprehensive training and certification program for state contracting and purchasing officials. General Services specifically identified the urgency for targeting training in the complex area of IT contracting.

General Services has developed a new contract and procurement review process whereby state departments doing high-risk procurements undergo an assessment review during the early stages of the contracting process. At that time, General Services determines if a contract needs developmental support, technical support, and/or legal support. General Services ensures that the type of review received is appropriate for the risk involved.

***Legislative Action: None.***

We are unaware of any legislative action implementing this recommendation.

**Finding #5: The State's contract with Oracle may not be enforceable.**

Our legal consultant has advised us that a court might find the ELA is not enforceable as a valid state contract because it may not fall within an exception to competitive bidding requirements. However, further analysis is required to understand the impact of a finding that the Oracle contract is unenforceable. For example, our legal consultant cautioned that even if a court found that the ELA contract is void for failure to comply with competitive bidding requirements, additional questions are raised by the financing arrangements for the \$52.3 million dollar loan under which Logicon assigned its rights to Koch Financial Corporation (Koch Financial). Because Koch Financial apparently acted in good faith and the State has received the full consideration for the loan—the enterprise license and one year of maintenance support—under the financing provisions, Koch Financial is likely to assert that the

State is obligated to repay the loan. Also, the State has agreed to stop using the ELA's enterprise database licensure if the Legislature does not appropriate funds for the loan payments or the State does not otherwise make payment and the ELA contract is terminated. More importantly, under the ELA contract the State also agreed not to replace the Oracle license with substantially similar database licenses for one year from the termination date.

Logicon's role, actions, and compensation from the ELA also raise troubling questions about the validity of the ELA contract. Specifically, the amount of compensation Logicon has or will continue to receive—more than \$28 million—for its undisclosed role in the ELA is too much to be merely compensation for being a lender and for the limited support services it will provide.

Finally, Logicon's erroneous savings projections may make the contract voidable. We arrived at vastly different numbers in reviewing the data that supports the costs and projections that Logicon presented to the State. For example, although Logicon projected that the State would save as much as \$16 million during the first six years of the contract, using Logicon's data and assumptions, we project that the State could spend as much as \$41 million more than it would have without the ELA.

For these reasons, we recommended that General Services should continue to study the ELA contract's validity in light of the wide disparities we identified in Logicon's projections of costs and savings and consult with the Office of the Attorney General (attorney general) on how to protect the State's best interests. General Services should also work with the attorney general in further analyzing the ELA contract; all amendments, including any and all documents pertaining to side agreements between Oracle and Logicon; and the laws and policies relating to the ELA, including the potential legal issues that this audit has identified.

***General Services' Action: Corrective action taken.***

As previously discussed, on July 23, 2002, the ELA with Oracle for database licenses and maintenance services was rescinded. General Services notified state departments of the rescission through the issuance of a management memo.

# CONTRACTORS STATE LICENSE BOARD

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## ***Investigations of Improper Activities by State Employees, July 2001 Through February 2002***

ALLEGATION I2000-753 (REPORT I2002-1), JUNE 2002

State and Consumer Services Agency's response as of March 2002<sup>1</sup>

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### ***Investigative Highlights . . .***

*A Contractors State License Board (CSLB) executive engaged in the following improper governmental activities:*

- Accepted \$4,000 from a non-state entity for performing duties related to his state function.*
- Circumvented civil service hiring practices by directing a CSLB contractor to pay an employee to work for the CSLB.*

**CSLB:**

- Made an emergency and subsequent permanent appointment of an employee that were illegal.*
  - Made other questionable or improper appointments of additional employees.*
- 

Along with the Department of Consumer Affairs (Consumer Affairs), which oversees the Contractors State License Board (CSLB), we investigated and substantiated allegations that an executive at the CSLB engaged in activities that were incompatible with his state position when he accepted payment from a non-state entity for serving on an advisory panel as part of his state duties. The same executive circumvented civil service hiring policies, did not disclose pertinent facts about a collision he had in a state vehicle, and made inconsistent statements to internal affairs investigators. Specifically, we found:

### **Finding #1: The executive engaged in incompatible activities.**

In violation of state law, the executive accepted \$4,000 from a non-state entity for serving on an advisory panel that was related to his state duties. The non-state entity selected the executive to be a member of its consumer advisory panel (advisory panel). The CSLB members were aware of and condoned the executive's participation in the advisory panel.<sup>2</sup> In addition, the executive told us that both he and the board members believed his participation was congruent with his duties at the CSLB.

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<sup>1</sup> Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2003, this is the date of the auditee's latest response.

<sup>2</sup> The CSLB has a 15-member board, appointed by the governor and the Legislature. The board appoints the CSLB executive officer and directs administrative policy.

After the non-state entity selected the executive to be part of the advisory panel for a two-year term, the executive participated in 14 separate events—10 meetings, 2 facility tours, a breakfast social, and a reception. The non-state entity paid the executive a total stipend of \$4,000, or \$400 for each of the 10 meetings he attended. The executive’s two-year term on the advisory panel ended in December 2000.<sup>3</sup> The executive violated state law by accepting payment from an entity other than the State for the performance of his state duties.

**Finding #2: The executive intentionally circumvented civil service hiring practices.**

Consumer Affairs concluded that the executive created a situation that would have allowed a CSLB contractor to “launder state contract funds.” The executive did this by directing a contractor to pay an employee, employee A, to work for the CSLB during November and December 1997, rather than following standard civil service procedures for the position. However, although Consumer Affairs concluded that the executive created this situation, it appears the laundering of state contract funds did not occur, because the contractor told us the CSLB did not reimburse it for the amounts it paid employee A.

**Finding #3: The CSLB made illegal emergency and permanent appointments of employee A.**

Although the contractor paid employee A only for work during November and December 1997, employee A continued to perform work for the CSLB during 1998 and 1999 under emergency and permanent appointments that the State Personnel Board (personnel board) ultimately determined to be illegal.

On February 2, 1998, the CSLB sent a memorandum to Consumer Affairs requesting that it make an emergency appointment of employee A to a Career Executive Assignment (CEA) position, retroactive to January 1, 1998.<sup>4</sup> According to the personnel board,

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<sup>3</sup> The executive left the CSLB and began working for another state agency effective August 14, 2000. According to a board member, since the last advisory panel meeting of the executive’s two-year term would be in October, they wanted him to complete his service.

<sup>4</sup> State law defines a Career Executive Assignment as an appointment to a high administrative and policy-influencing position within the state civil service in which the incumbent’s primary responsibility is the managing of a major function or the rendering of management advice to top-level administrative authority.

Consumer Affairs approved the appointment, though its reason for doing so is unclear. Clearly, the employee already had been working for the CSLB without any formal agreement or approval.

State law allows departments to make emergency appointments under certain circumstances, including preventing the stoppage of public business when an actual emergency arises. According to the personnel board, emergency appointments provide flexibility for responding to staffing needs that are so urgent, unusual, or short term that they cannot reasonably be met through other civil service appointment procedures. In March 1999, the personnel board concluded that there was nothing unusual or of an emergency nature that required the filling of a CEA position with an emergency appointment. In fact, it found that the record reflected that the CSLB was deliberately avoiding the competitive employment process.

On March 23, 1998, the CSLB announced an examination for the permanent CEA position. Nine candidates, including employee A, applied for the position. The CSLB reported that on April 1, 1998, a two-person evaluation panel that included the executive screened the applications based on detailed rating criteria. No interviews were held. The CSLB permanently appointed employee A to the position on the same day as the evaluation. The personnel board determined that the permanent appointment was illegal because the position never was established through the required process; preselection of employee A was evident; and the examination was a spurious process intended to give the appearance of a competitive examination.

The personnel board canceled employee A's illegal appointments, both the emergency and permanent appointment. Employee A, with the support of the CSLB, appealed the decision, and the personnel board ultimately overturned the cancellation of the emergency appointment because more than one year had passed between the appointment and the personnel board's attempt to cancel it. State law permits the personnel board to declare an appointment void from the beginning if such action is taken within one year after the appointment when an appointment was made and accepted in good faith but was unlawful. The cancellation of the permanent appointment was not overturned. Because it found no evidence that employee A had acted in other than good faith when he accepted the appointments, the personnel board allowed employee A to retain the \$75,485 in compensation he earned from January 1998 through March 1999.

**Finding #4: The CSLB made other questionable or improper appointments.**

On April 13, 1999, the personnel board notified the CSLB that, in light of its recent findings regarding the processes the CSLB used to select and appoint individuals for CEA positions, it was revoking the CSLB's authority to conduct examinations for these assignments. State law gives the personnel board's executive officer the authority to delegate selection activities to an appointing power. When the personnel board has substantial concerns regarding a department's capability in this regard, it can require that it preapprove or be involved with all aspects of the examination process.

***Agency Action: Pending.***

The State and Consumer Services Agency (agency), which oversees Consumer Affairs, plans to provide briefings to key departmental managers on compliance with ethical standards and to determine other appropriate actions that could be taken to prevent a recurrence of this type of behavior. In addition, the agency secretary has asked for a review to determine whether further actions should be taken against the subject employee, even though the employee has retired from state service.

# OFFICE OF CRIMINAL JUSTICE PLANNING

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## ***Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery***

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### ***Audit Highlights . . .***

*The Office of Criminal Justice Planning (OCJP) has not fulfilled all of its responsibilities in administering state and federal grants, including the domestic violence program. Specifically, OCJP:*

- Has not adopted guidelines to determine the extent it weighs grant recipients past performance when awarding funds.*
- Does not always provide grant applicants the necessary information or time to challenge its award decisions.*
- Missed opportunities to seek guidance an advisory committee could provide regarding program administration.*
- Has not consistently monitored grant recipients.*
- Spent \$2.1 million during the last three years on program evaluations of uneven quality, content and usefulness.*

*continued on next page*

REPORT NUMBER 2002-107, OCTOBER 2002

Office of Criminal Justice Planning and Department of Health Services' responses as of November 2003

The Joint Legislative Audit Committee (audit committee) requested an audit of Office of Criminal Justice Planning's (OCJP) administration of its grant programs in general and of its and the Department of Health Services' (DHS) administration of their respective domestic violence programs in particular. The audit committee also asked us to identify alternatives to the current administrative structures for the domestic violence programs. We reported the following findings:

### **Finding #1: Weaknesses in OCJP's process for awarding grants may result in the appearance that its awards are arbitrary or unfair.**

OCJP has not adopted guidelines weighing grant recipients' past performance when awarding funds, nor is its review process systematic enough to identify grant recipients with poor past performance. Moreover, OCJP does not always provide unsuccessful grant applicants the necessary information or time to challenge its award decisions, and it has missed opportunities to seek the guidance an advisory committee could provide regarding certain decisions that affect program administration.

To ensure its application process is perceived as fair and impartial, we recommended that OCJP take the following steps:

- Create guidelines and criteria to determine when an applicant's past performance issues rise to the level that OCJP will consider those issues when deciding whether or not to continue the applicant's funding.

*Our review of the domestic violence programs administered by OCJP and the Department of Health Services (DHS) revealed that:*

- OCJP decided not to correct an inconsistency in its 2001 request for proposals, which resulted in fewer shelters receiving funding.*
- DHS has not established guidelines as to how past performance will be considered when awarding grants.*
- OCJP and DHS award the majority of their domestic violence funds to shelters for the provision of similar services.*
- OCJP's and DHS's activities for awarding grants and providing oversight of recipients sometimes overlap.*

- Conduct a periodic uniform review of all applicants with regard to past performance issues that includes applying weighting factors that indicate the relative importance of each such issue as it relates to future funding.
- Promptly inform grant recipients when their past performances are jeopardizing their chances for future funding.
- Properly document the rationale not to fund grant recipients and clearly state in the rejection letters sent to the applicants the reasons that they were denied funding.
- Change the process for the filing of appeals so that an applicant has 10 to 14 calendar days, depending on the type of grant award, from the registered receipt of the notification letter in which to justify and file an appeal.

To improve outreach to its grant recipients and comply with legislation that is soon to take effect, we recommended that OCJP create an advisory committee for the domestic violence program that could provide guidance on key program decisions.

***OCJP Action: Partial corrective action taken.***

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that it had created a formal written policy to use when considering the past performance of an applicant as a factor in its funding decisions and that the new policy will be used for those applying for competitive funding under OCJP's next request for proposal. However, we reviewed the new policy and, while we believe it is a good first step, it is still too vague and subject to varying interpretation.

In order to address the possible view that the current appeals guidelines are overly strict in terms of the time allowed to file an appeal and that the denial notice is too limited concerning the reasons for the denial, OCJP has revised its appeals guidelines. The guidelines were reviewed and approved by an independent council that hears such appeals at the end of July 2003. The new guidelines, which were implemented August 1, 2003, permit more time to appeal and provide more information to those applicants that are denied.

Finally, OCJP stated it would work with the agency that will be administering the domestic violence program beginning in 2004—the Office of Emergency Services—to establish a Domestic Violence Advisory Committee that will provide insight and guidance in administering the domestic violence program.

**Finding #2: OCJP does not provide consistent and prompt oversight of grant recipients.**

Although OCJP conducts a variety of oversight activities, its efforts lack consistency and timeliness. It has not visited grant recipients as planned and has not considered prioritizing its visits to first monitor recipients with the highest risk of problems. It has also been inconsistent in following up on its grant recipients' submission of required reports, and it has not always reviewed required reports promptly and consistently. In addition, it has spent nearly \$23,000 per year to review audit reports that another state agency also reviews. Finally, it has not always conducted sufficient follow-up on reports once it notified grant recipients of performance problems.

We recommended that OCJP take several actions to improve its oversight of grant recipients, including:

- Ensure prompt site visits of newly funded grant recipients.
- Establish a risk-based process for identifying the grant recipients it should visit first when it conducts monitoring visits.
- Develop written guidelines to determine when and how staff should follow up on late progress reports and ensure that existing guidelines are followed regarding the prompt follow up on late audit reports.
- Ensure that it reviews audit reports within six months of receipt in order to comply with federal guidelines and promptly follow up on audit findings until they are resolved.
- Revise its process for reviewing the audit reports for municipalities to eliminate duplicating the State Controller's Office's (SCO) efforts.
- Establish written guidelines to address how staff should follow up on problems identified in progress reports or during site visits to ensure they are resolved.

- Require that its monitors review grant recipients' corrective action plans to ensure problems identified during monitoring visits have been appropriately addressed through problem-specific narratives.

***OCJP Action: Partial corrective action taken.***

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that it has a goal of conducting one technical site visit for a new grant recipient within the first six months of the grant period and one monitoring visit within the three-year grant period. Therefore, at a minimum, every grant recipient should receive a visit at least once every three years. OCJP also stated it was continuing to implement its plan to prioritize monitoring visits based on identified problems, the length of time since the last visit, and the dollar value of the project. Once its grant programs are transferred to other agencies, OCJP stated it would work with the receiving agencies to ensure a smooth transition of the monitoring function.

OCJP stated that it has made significant progress in reducing its backlog of pending reviews of grantee audit reports. For example, OCJP reports it has reviewed 235 audit reports as of October 2003, and anticipates it will complete reviews of 269 more before it ceases operations at the end of the year, and will work with the agencies taking over its grant programs so that work continues on reducing the backlog. Finally, OCJP stated it intends to provide the written guidelines for its grant programs to those agencies slated to administer them once they are transitioned and will also help those agencies develop procedures for following up on problems identified in grantee progress reports, technical or monitoring site visits, or other sources such as audit reports.

**Finding #3: OCJP has not properly planned its evaluations or managed its evaluation contracts.**

During the last three years, OCJP's evaluation branch spent \$2.1 million on activities that culminated in evaluations of uneven quality, content, and usefulness. The branch lacks a process that would help it determine what programs would profit most from evaluations, how detailed evaluations should be, what criteria evaluations must satisfy, and, until recently, how to ensure they contain workable recommendations. The branch has been lax in management of its contracts; as a result,

it did not include measurable deliverables in one contract and failed to ensure that it received the deliverables contained in others. It also circumvented competitive bidding rules in entering an agreement with a University of California extension school.

To improve its evaluations branch, we recommended that OCJP:

- Develop a planning process to determine what programs would profit most from evaluations, how rigorous evaluations should be, and that it follow its new process for discussing the relevance and feasibility of proposed recommendations to improve their chances for implementation.
- Develop general criteria establishing what evaluations should accomplish.
- Include measurable deliverables and timelines in its contracts with evaluators and hold evaluators to their contracts.
- Withhold payments to contractors whenever they do not provide established deliverables or when the deliverables are not of the quality expected.
- Ensure that interagency agreements with university campuses comply with state guidelines regarding competitive bidding.

***OCJP Action: Partial corrective action taken.***

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that significant efforts have been made to identify and prioritize those evaluations that are mandated, and it is working to ensure that evaluation criteria and requirements are met. A new interim chief was assigned to oversee evaluation activities and has since issued five evaluation reports with plans to issue one more before OCJP ceases operations at the end of the year.

**Finding #4: OCJP’s allocation of indirect and personnel costs may have resulted in some programs paying for the administration of others.**

OCJP’s method for assigning indirect and personnel costs to the various programs it administers may result in some programs paying the administrative costs for others. Its allocation of indirect costs has been inconsistent, and it has not kept adequate records of

its allocation decisions to demonstrate that they were appropriate. OCJP has also failed to require its employees to record their activities when working on multiple programs as required by federal grant guidelines.

We recommended that OCJP ensure that it equitably allocates all indirect costs to the appropriate units and maintains sufficient documentation to support the basis for its cost allocation. OCJP also should establish an adequate time-reporting system that uses activity reports or certifications, as appropriate, to document the total activity for each employee and then use such reports or certifications as the basis for allocating personnel costs.

***OCJP Action: Corrective action taken.***

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that it had designed a functional timesheet modeled after those used by other state agencies, trained its staff on its use, and fully implemented the timekeeping system as of May 2003. The timesheets better ensure that costs are accurately recorded in the accounting system.

**Finding #5: OCJP’s decision not to correct an inconsistency in its request for proposals resulted in fewer domestic violence shelters receiving funding.**

OCJP funded almost three fewer domestic violence shelters than it could have in fiscal year 2001–02 because it chose not to correct an inconsistency in the 2001 request for proposals for its domestic violence grant. This decision resulted in a reduction of nearly \$450,000 a year of funds available for shelters. The error occurred during the development of its request for proposals, when program staff set the minimum amount that a small shelter would receive at \$185,000 a year, even though an adjoining table within the proposal stated that \$185,000 was the maximum amount that a small shelter could receive. The minimum amount was over \$30,000 more for some small shelters than the minimum OCJP had previously awarded.

OCJP could provide no documentation of the decision-making process it used to arrive at the \$185,000 funding minimum, such as written input from the shelters stating that the previous minimum amount was insufficient. Furthermore, OCJP provided

no indication that it had considered the consequences that raising the minimum funding amount of some shelters by as much as \$30,000 would produce.

So that it can support and defend future funding decisions affecting the domestic violence program, we recommended that OCJP document and retain the reasons for changing funding levels.

***OCJP Action: Pending.***

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its grant programs will be transferred to other state agencies. Prior to its closure, OCJP stated that Senate Bill 1895 provided the authority to create an advisory council effective January 1, 2003, that could recommend specific future funding levels for all shelters in OCJP’s domestic violence program. Further, OCJP stated it would work with the agency that will be administering the domestic violence program beginning in 2004—the Office of Emergency Services—to establish a Domestic Violence Advisory Committee that can provide such insight and guidance.

**Finding #6: DHS has not considered past performance or been able to use its advisory committee when awarding grants.**

DHS has not adopted guidelines or criteria to establish when a grant recipient’s past performance has been sufficiently poor to prevent it from being awarded funds during the next grant cycle, nor has it established a systematic review process to identify grant recipients with poor past performance. Further, forces outside of its control precluded DHS from seeking counsel from a domestic violence advisory committee as required by state law.

We recommended that DHS develop guidelines and criteria to determine when a grantee’s past performance warrants denying it funding in the next grant cycle, which would include performing a periodic uniform review of all grant recipients’ past performance. Also, now that enough appointments have been made to the advisory council to create a quorum, DHS should meet frequently with the council to seek its input as required by law.

***DHS Action: Partial corrective action taken.***

DHS stated that it has begun to meet regularly with the domestic violence advisory council and will request that the council consider whether it should use the past performance of grant recipients in preparation for awarding funds in future Request for Applications (RFA). If past performance is to be used in determining grant awards, DHS will develop specific criteria.

**Finding #7: DHS has not fully met its responsibility to oversee grant recipients.**

DHS does not have a process to conduct state-mandated site visits of its grant recipients. Moreover, it has not considered prioritizing its visits to first monitor those with the highest risk of problems. It has also been inconsistent in following up on its grant recipients' late submission of required reports, and it has not always reviewed required reports promptly and consistently.

To ensure better oversight of its shelters, we recommended that DHS:

- More efficiently use its resources when complying with state law mandating technical site visits to all its shelters by establishing a risk-based process for identifying which shelters it should visit first.
- Develop a structured process for staff to use to follow up on late progress reports. This process should include documenting follow-up efforts.
- Ensure that staff follow existing guidelines regarding the prompt follow-up of late audit reports.
- Ensure that it reviews all submitted progress reports promptly.

***DHS Action: Corrective action taken.***

DHS stated that it has put a system in place to ensure that timely review and follow up of progress reports occurs and that the system includes a status log that lists all the deliverables required from the shelters, including progress reports. The status log contains a "notes" column to record staff follow-up efforts regarding late reports, and all written communication or e-mail contacts with the shelters will be maintained in the working file.

In addition, DHS stated that it had developed and maintains an audit-tracking log to monitor the receipt of audit reports, and has developed guidelines to ensure that audit reports are received on time. Finally, DHS stated that it is on schedule to complete at least one site visit to each shelter within the current grant cycle as required by law.

**Finding #8: OCJP and DHS require separate grant applications for similar activities.**

OCJP and DHS conduct separate grant application processes. As a result, shelters must submit separate applications describing how they will use each program's funds, although the applications and the services themselves are similar.

To reduce the administrative burden for the shelters, we recommended that OCJP and DHS coordinate the development of the application processes for their shelter-based programs and identify areas common to both where they could share information or agree to request the information in a similar format.

***OCJP's and DHS's Actions: Pending.***

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its domestic violence programs will be transferred to the Office of Emergency Services. DHS stated it would continue its efforts to coordinate the application process for the shelter-based program with this new administering agency.

**Finding #9: OCJP and DHS perform some of the same oversight activities.**

OCJP and DHS require shelters to submit periodic progress reports containing similar information, except that each requires the information for a different time period. Furthermore, as a result of a new legislative requirement, DHS will perform site visits to shelters to assess their activities and provide technical assistance, even though OCJP already conducts such visits.

To avoid duplicate oversight activities, we recommended that OCJP and DHS consider the following changes to their administrative activities and requirements:

- Align the reporting periods for their progress reports so that shelters do not have to recalculate and summarize the same data for different periods.

- Coordinate technical site visits, monitoring site visits, and audits that they schedule for the same shelters.
- Establish procedures for formally communicating on a regular basis with each other their ideas, concerns, or challenges regarding the shelters.

***OCJP's and DHS's Actions: Pending.***

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its domestic violence programs will be transferred to the Office of Emergency Services.

DHS stated it would continue its efforts to coordinate the oversight process for the shelter-based program with this new administering agency to avoid duplication.

**Finding #10: Greater cooperation or consolidation between OCJP's and DHS's programs could increase efficiency.**

Because of the similarity of OCJP's and DHS's programs and the overlap between their application and oversight activities, adopting an alternative administrative structure could improve the efficiency of the State's approach to funding domestic violence services.

To improve the efficiency of the State's domestic violence programs and reduce overlap of OCJP's and DHS's administrative activities, we recommended OCJP and DHS, along with the Legislature, should consider implementing one of the following alternatives:

- Increase coordination between the departments.
- Develop a joint grant application for the two departments' shelter-based programs.
- Combine the two shelter-based programs at one department.
- Completely consolidate all OCJP's and DHS's domestic violence programs.

***OCJP's and DHS's Actions: Pending.***

According to the 2003–04 Budget Act, OCJP will be eliminated effective January 1, 2004, and its domestic violence programs will be transferred to the Office of Emergency Services. DHS stated it would continue its efforts to coordinate the process for administering the shelter-based program with this new agency to avoid duplication.

***Legislative Action: Unknown.***

We are not aware of any legislative action with regard to this recommendation.



# DEPARTMENT OF GENERAL SERVICES

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## ***Certain Units Can Do More to Ensure That Client Fees Are Reasonable and Fair***

REPORT NUMBER 2002-108, DECEMBER 2002

Department of General Services' response as of December 2003

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### ***Audit Highlights . . .***

*We found that certain units within the Department of General Services (General Services) often missed their estimates of project fees charged to client departments by more than 20 percent. These units, which are within General Services' Real Estate Services and Telecommunications divisions, could improve the accuracy of their estimates by more consistently employing the following best practices:*

- Document how estimates are calculated.*
- Ensure the review and approval of estimates.*
- Use multiple estimating approaches—along with historical data—to validate estimates.*
- Evaluate estimates on completed projects.*

*Further, we found that certain units could more accurately prepare and report cost data that General Services' management uses to decide on hourly rates. Finally, the Office of Public Safety Radio Services needs to improve its billing practices.*

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The Joint Legislative Audit Committee (audit committee) requested the audit after hearing concerns from the Legislative Analyst's Office (LAO) regarding the appropriateness of the Department of General Services' (General Services) capital outlay project management fees. We evaluated General Services' estimates of fees it charges departments for capital outlay and telecommunications projects—which generated three-quarters of General Services' project management fees during fiscal year 2001–02—and concluded that improvements can be made. Specifically, we found:

### **Finding #1: Some units do not always follow best practices or their own procedures when estimating project costs and fees.**

Although units within General Services' Real Estate Services Division (Real Estate Services) and Office of Public Safety Radio Services (Radio Services) do well with certain aspects of estimating costs and fees for capital outlay and radio equipment installation projects, they do not always follow the best practices we identified or their own procedures. Specifically, staff were unable to provide us with documentation to demonstrate how the estimators derived the estimated cost for all line items for eight of the 10 projects we reviewed. In addition, Radio Services could not always demonstrate that its project estimates received either client or supervisory approval. The lack of client approval for two projects may lead to Radio Services absorbing \$93,000 of the projects' costs. Moreover, these units are not consistently using multiple cost estimating approaches—along with historical data—when preparing estimates and are not conducting end-of-project reviews to evaluate the success of their estimates. We also found that Radio Services had not compared actual results to the estimates it generated using an estimating tool. As a result of these deficiencies, General Services cannot ensure that fees charged to client departments for these services are reasonable and fair. Further, the significant variances we found in project

estimates and line item estimates—many exceeding actual costs by more than 20 percent—further support the need to follow best practices when estimating fees.

To ensure that its estimates of project costs and fees are accurate and defensible and to improve the reliability of its process for estimating project costs, we recommended that General Services employ the following best practices:

- Adopt and follow a procedure to thoroughly document assumptions used in creating project estimates.
- Document evidence of supervisory and client review and approval and, if needed, develop a process for expedited client approval when clients of Radio Services insist that projects start immediately.
- Conduct evaluations at the end of each major project.
- Develop a historical database of completed projects and use the database to provide support for future estimated project costs for all major projects.
- Use multiple cost-estimating approaches for all significant line item estimates of major projects.
- Periodically review the performance of its cost-estimating tools against actual results and update the tools when necessary.

***General Services' Action: Partial corrective action taken.***

General Services agrees with the elements of best practices identified in our report and is striving to implement processes that include those practices. Specifically, General Services states that both Real Estate Services and Radio Services now require staff to document assumptions used to prepare fee and project estimates, along with the supervisory approval of these estimates. However, Radio Services continues to begin work on telecommunications projects before clients approve the costs, but does require that clients put their requests to start work on projects without approved costs in writing. While Real Estate Services indicates it has taken steps to better evaluate the estimates for completion projects, Radio Services believes that it is unable to perform in-depth post-evaluations of all major telecommunications

projects until it implements a new system known as the Automated Enterprise Support and Oversight Product system. This system will integrate Radio Services' existing automated and manual systems to allow for better management of its business practices. Because Radio Services does not expect to award a contract to develop this system until January 2004, it modified existing systems to include more relevant budget and cost information for staff to use when making estimates. Finally, General Services states that as more historical cost information becomes available, both Real Estate Services and Radio Services will be able to use additional cost estimating approaches.

**Finding #2: Reports used to determine client hourly rates do not always reflect actual costs and Fiscal Services does not always allocate its overhead fairly.**

Although General Services' process for developing the hourly rates of staff—which are the basis of many fee estimates—appears reasonable, it can improve the accuracy of a report that management uses to decide on the hourly rates. Units that provide services—with the assistance of General Services' Office of Fiscal Services (Fiscal Services)—provide management a report to allow it to make the decisions on hourly rates. The report recommends hourly rates for each type of service and is designed to include the at-cost rate for each service, which is calculated by dividing projected costs by the projected billable hours. However, we found that Radio Services' staff made \$10.2 million in arbitrary or unsupported adjustments, such as shifting costs between units when calculating its at-cost rate. In addition, Fiscal Services allocated its overhead—which amounted to \$7.6 million for fiscal year 2001–02—to units based partly on the units' ability to absorb the costs rather than on actual services provided. Although some of these adjustments may be justified, staff told us that some of the adjustments were made to achieve hourly rates similar to the prior-year rates. This preliminary “leveling” process distorts the picture that management sees when making rate decisions, and may lead to setting rates inappropriate to recover actual unit costs. In addition, some adjustments cause other units within General Services to shoulder more than their fair share of costs.

To ensure that the reports General Services uses in setting hourly rates reflect the true projected cost for each unit, we recommended that it require units to include in their

cost-recovery proposals the actual, unadjusted, at-cost hourly rate and clearly document the existence of and retain support for any adjustments designed to achieve a desired or recommended hourly rate. Also, to improve its method of allocating overhead and to make the process more objective, Fiscal Services should consider using another method to allocate its overhead costs to other units, such as using an average of two or three years' actual costs per unit.

***General Services' Action: Corrective action taken.***

General Services stated that as a part of its annual financial plan process, its executive management team will be provided at-cost rates as well as various other rate scenarios that will impact an operating unit's ability to be financially solvent and avoid rate volatility. In addition, Radio Services now requires that staff retain all documents and data to support adjustments to hourly rate calculations. Finally, Fiscal Services has revised its method of allocating its overhead costs to other General Services' units to be based on the average actual cost of services provided to each unit from the most recent three fiscal years.

**Finding #3: Radio Services can improve its methods for assessing consulting fees related to system services and can improve its billing practices.**

In addition to installing and maintaining telecommunications equipment, Radio Services provides consulting services such as preparing cost studies, developing reports, attending client meetings, and common services such as Federal Communication Commission (FCC) license renewals, representing the State before the FCC, and developing equipment specifications. However, we could not determine whether the consulting fees that Radio Services charges to client departments were reasonable and fair because of weaknesses in its cost accounting system. Further, we also found that Radio Services does not review for errors in invoices before they are sent to departments but instead it relies upon departments to detect billing errors. In one instance, the lack of review resulted in an under billing of \$126,000 to a department. Compounding the problem is that Radio Services' invoices generally contain insufficient detail to allow departments to detect billing errors.

To improve the reliability and accuracy of its client fees, we recommended that Radio Services improve its cost accounting system so that it can ensure billings to client departments are reasonable and fair. In addition, we recommended that Radio Services review the accuracy of all invoices and continue its efforts to provide its clients with an adequate amount of invoice detail for them to review the accuracy of charges.

***Radio Services' Action: Partial corrective action taken.***

Radio Services reports that it has improved the controls over how staff charges time to client departments and strengthened the procedures for reviewing client invoices. In addition, for departments that request to be billed an annual fixed amount for services, Radio Services now bases these invoices on a three-year average of past costs to provide these services. However, Radio Services believes that it cannot provide client departments additional invoice detail to review the accuracy of charges until after it implements the Automated Enterprise Support and Oversight Product system. As mentioned previously, Radio Services does not expect to award a contract to develop this system until January 2004.



# CALIFORNIA STATE UNIVERSITY

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## ***Its Common Management System Has Higher Than Reported Costs, Less Than Optimal Functionality, and Questionable Procurement and Conflict-of-Interest Practices***

REPORT NUMBER 2002-110, MARCH 2003

California State University response as of September 2003

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### ***Audit Highlights . . .***

***Our review of the California State University's (university) Common Management System (CMS) revealed the following:***

- The university did not establish a business case for CMS to define its intended benefits and associated costs and ensure that the expenditure of university resources is worthwhile.***
- The university's previous cost projections understated the full costs of CMS over its now nine-year project period; these costs—including an estimated \$269 million for maintenance and operations—are now expected to total \$662 million.***
- Problems exist that cast doubt on whether CMS will achieve all the objectives intended, nor offer what could have been achieved from a systemwide project.***

*continued on next page*

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the California State University's (university) Common Management System (CMS) project. Specifically, the audit committee asked that we identify the initial cost estimates and current projected costs for CMS including integration costs, consultant costs, data center costs, and the university's funding sources for these related expenditures. Additionally, the audit committee asked us to identify the university's needs, benefits, and return on investment from CMS and its supporting data center. The audit committee also asked us to review the university's management and oversight for CMS and its supporting data center, the university's process to select the software, hardware, and consultants contributing to the CMS project, and how implementation has affected growth in employee positions and workload. The audit found the following:

### **Finding #1: The university did not develop a business case for CMS.**

The university did not establish a business case for CMS by preparing a feasibility study report that evaluated the need for and the costs and benefits of this new administrative computer system. Without such a feasibility study, the university lacks persuasive answers to the Legislature's questions about its use of state resources for CMS and its supporting data center.

The Public Contract Code requires state agencies to follow the State Administrative Manual (SAM) when acquiring information technology (IT) goods and services. To ensure compliance with the code's intent, the SAM procedures include a need and

- ☑ *Although the university followed recommended procurement practices to acquire data center services, its procurements for software and consultants on the project raise questions about the fairness and competitiveness of the university's practices.*
  - ☑ *The university did not do enough to prevent or detect apparent conflicts of interest on CMS-related procurements.*
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cost-benefit analysis. According to SAM, a feasibility study “must establish the business case for the investment of state resources in [an IT] project by setting out the reasons for undertaking the project and analyzing its cost and benefits.” However, under Public Contract Code Section 12100.5, the university is exempt from certain state oversight and approval of its IT procurements. The university believes the Public Contract Code further exempts it from following SAM regarding feasibility study reports, although the statute requires the university to adopt policies and procedures that further the legislative policy expressed in the code.

Regardless of the applicability of SAM feasibility study procedures to its own practices, the university would have been in a stronger position to answer legislative and public questions concerning the need for CMS if it had performed a need and cost-benefit analysis consistent with SAM. Had the university conducted a feasibility study that mirrored the SAM requirements, it would have maintained sufficient documentation to support the project’s intent, justification, nature, and scope. Additionally, performing such a feasibility study would have provided the university with an opportunity to quantify the increased business process efficiencies expected from CMS. Although the university has given various reasons for pursuing a systemwide implementation of CMS, individually and collectively they do not justify spending \$662 million over the nine-year project period, an estimated \$393 million in one-time costs and \$269 million in maintenance and operations costs, without establishing the business case.

To ensure that the university’s future IT projects are appropriate expenditures of state resources, the university should adopt policies and procedures that require a feasibility study before the acquisition and implementation of significant IT projects. Such a feasibility study should include at least a clearly defined statement of the business problems or opportunities being addressed by the project, as well as an economic analysis of the project’s life-cycle costs and benefits compared with the current method of operation. The university should also establish quantitative measures of increased business process efficiencies to measure the benefits achieved through common management and business practices.

***University Action: Partial corrective action taken.***

The university stated that it issued an executive order establishing policies and procedures requiring feasibility studies for significant IT projects. Additionally, the university asserted that it worked with the Legislature on specific statutory requirements for feasibility studies regarding university IT projects and will revise its policies pending new statutory requirements and to provide the more comprehensive guidance we recommended in our May 2003 letter to the chancellor. The university further indicated that it would involve its existing quality improvement process to measure process efficiencies and would begin with producing a list of qualitative and quantitative measures of process efficiencies. It expected to put in place a structure for collecting these measurements by December 2003.

**Finding #2: The university's CMS project costs exceed initial estimates, and its cost monitoring procedures are inadequate.**

Recent project cost data indicate that the university's earlier 1998 and 1999 cost estimates of between \$332 million to \$440 million for its CMS project understated the project's costs. A more comprehensive review of actual CMS expenditures and projections in June 2002 revealed that total project costs for the types of expenses the university initially estimated—what it considers to be “new” costs—now total \$482 million. Additionally, this \$482 million excludes other project-related campus costs the university did not include in its estimates because its focus was only on “new” costs. These other project-related costs include \$63 million in implementation costs charged to other campus budgets and \$117 million in campus maintenance and operations costs over the now nine-year development and implementation period, bringing the total projected costs to \$662 million.

Moreover, the university cannot accurately report on the project's expected systemwide costs because it has not established an ongoing process to capture and monitor the costs campuses actually are incurring or projecting to incur. Although it tracks central project costs, the chancellor's office does not track campus costs because it believes they are a campus responsibility. As a result, the university was not aware of its total systemwide costs for the CMS project until campuses had reported their actual and projected CMS costs in a June 2002 survey. Furthermore, the university has not reported

to the Legislature a clear picture of the project's financial status. In its November 2002 Measures of Success report to the Legislature, the university reported the project budget for fiscal years 2000–01 and 2001–02 at \$30 million and \$31 million, respectively, and the actual costs “at budget;” however, it did not report campus costs which totaled \$29 million and \$47 million in those respective fiscal years.

Additionally, although the university tracks central project costs, it did not use project status reports that periodically track variances between the actual and projected CMS costs on the one hand and the initial and revised CMS project budgets on the other. Prudent project management calls for establishing approved initial budgets and tracking actual costs, enabling managers to report and monitor project progress through periodic status reports that analyze variances between the planned budget and the actual costs. These variances measure project performance and assist management in controlling the project schedule and costs by predicting shortcomings and reducing the risk of exceeding the budget.

Similarly, the university does not have a comprehensive systemwide funding plan for the CMS project. The university's funding plan only addressed expected CMS expenditures at the chancellor's office, not any campuses' funding needs. The chancellor's office expected campuses to determine their own costs and funding necessary to implement CMS. However, our funding survey determined that only seven of 23 campuses were able to provide funding plans for their projected CMS costs. When it does not finalize funding for all CMS costs up front, the university lacks a clear understanding of how the CMS project funding needs may affect its ability to meet other priorities, such as academic needs.

To ensure that it adequately monitors and controls project costs, the university should determine the quarterly cost information it needs to adequately monitor the project. After making this determination, the university should establish a mechanism to collect and compile comprehensive and systemwide project cost information that includes campus costs. Further, the university should compare the collected cost information against the approved systemwide project budget, publishing this information in a quarterly status report. The university should also ensure that it includes all costs of the CMS project in its annual reports to the Legislature, as well as ensure that the CMS

project and all future IT projects have a systemwide funding plan that covers the entire scope of the project in place before beginning a project.

***University Action: Partial corrective action taken.***

The university stated that it was in the process of determining the campus cost information necessary to monitor the project and establishing a mechanism to collect and report this data on a systemwide basis. It expected to complete these tasks by the end of October 2003. Additionally, the university stated that it would implement annual reporting of campus and central expenditures in its annual Measures of Success Report to the Legislature beginning with the November 2003 report. Finally, the university asserted that it will ensure that future IT projects have comprehensive funding plans and will ensure that its CMS project funding plan includes both its central CMS and campus plans. It expected to establish a process for collecting and reporting CMS funding plans for each campus and combine these in a systemwide report by December 2003.

**Finding #3: CMS may not achieve all of the university's business objectives due to the university's weak planning efforts early in the project and its limited expectations with regard to systemwide reporting.**

The university expects to accomplish certain business objectives with its CMS project, but problems noted during our review indicate that CMS may neither fully achieve those objectives nor offer what could have been achieved from such a systemwide project. Doubts about CMS fully accomplishing its business objectives and achieving the potential of a systemwide implementation can be traced to the university's weak efforts early in the planning process and limited expectations with regard to systemwide reporting.

Although it initially planned to make as few modifications as possible to the PeopleSoft software, the university ultimately found that it needed to make about 200 modifications to the initial versions of the software applications to meet business requirements and other campus needs. Compounding the time and costs for modifications, PeopleSoft periodically releases new versions of the CMS software, and the university intends to keep current with those releases. Thus, the university will need to reapply many of the CMS modifications to the new

releases, adding potentially significant maintenance costs in reapplying, testing, and implementing these modifications. Although we recognize that not all modifications take the same amount of time and effort, we are unable to quantify which modifications were most costly because the university did not track modification costs. Moreover, before purchasing the software, the university did not sufficiently evaluate its specific business processes and software to understand up front which business processes the potential vendors' software products could accommodate and which software products would require modification to meet its business needs. Failing to make these evaluations up front, the university had no basis to anticipate the extent of software modifications it eventually would make or the loss of functionality some campuses would experience.

Furthermore, the university intended CMS to meet the business objectives of providing ready access to current, accurate, and complete administrative information, as well as establishing standards for common reporting processes. However, the university is not implementing the CMS software throughout the university in a manner that will maximize systemwide reporting. Instead of installing shared databases, the university has been installing separate and distinct databases for all but two campuses. Separate databases must be separately maintained and tested. Additionally, a wide variation in functionality across campuses will result because most campuses are not planning to implement all the modules or sub-modules (functionality elements) purchased under the PeopleSoft agreement and the functionality elements the university created for CMS, because the PeopleSoft software did not provide the needed functionality. This lack of uniformity raises the cost of implementing and maintaining the CMS software and limits its usefulness in producing systemwide reports.

The university has also experienced problems with fixing software errors and with information security. Although providing updates and fixing some minor software errors to its newly modified CMS software is expected, the university also needed to make corrections and redistribute some of these CMS software updates and fixes. When the university takes more than once to provide complete updates or fix some errors, campuses must spend more time and money redoing their work or assume the risk of potential system errors. Furthermore, the university has not fully addressed the lack of security around a search feature in the PeopleSoft software that apparently allows employees access to the confidential information of other

employees and students beyond what is needed to do their jobs. The university might have reduced the need to rework software fixes and improved information security had it established an effective quality assurance function. Also, hiring an independent oversight consultant may likely have assisted the university in identifying and addressing quality assurance and information security deficiencies earlier in the CMS project.

Finally, the university's procurement approach of identifying, procuring, and implementing its own solution caused it to assume substantially all the responsibility for the CMS project, sharing little if any project risk with vendors and consultants. The university procured the software for the CMS project in September 1998, ultimately agreeing to pay PeopleSoft \$37 million to use the software for the next eight years and for an initial amount of training and consulting services. It then hired consultants on an hourly basis to help it identify campus business needs, to design and develop the modifications needed for the software, and to help implement this software at campuses throughout the university system. However, the university could have structured its procurement so that, in return for a fixed fee, the winning firm would be responsible primarily for the successful implementation of whatever software product the university decided to use. The university then could have entered into a contract that paid the firm only upon completion of key deliverables, such as the successful modification of functionality elements within the software to meet the university's needs. Structuring contracts to pay only after deliverables have been tested and accepted is a recommended procurement practice. Instead, the university chose to purchase only the software, and it is conducting the substantial amount of work, with the assistance of consultants paid through additional contracts, necessary to ensure that the software is modified and implemented properly. The university concluded that it was best for it to modify and implement the software, but it never performed sufficient analysis to determine that a university installation provided the best value. As a result, it assumed the considerable financial and business risk involved in ensuring that the software meets its business needs and is implemented successfully at campuses.

To ensure that it achieves its stated business objectives for CMS, the university should continue its recently established practice of tracking actual hours spent on software modifications and consider this information when estimating the cost and time associated with developing and applying future software

modifications. Also in the future, the university should evaluate its specific business processes against vendor products before procuring IT systems, so as to select the product that best accommodates the university's specific needs. The university should also reassess the design of CMS and evaluate the economies that can be achieved by reducing the number of separate CMS databases. Similarly, the university should define the scope and associated costs of CMS by identifying the specific functionality that is necessary and establish a minimum level of functionality that all campuses will implement to not only minimize costs, but also to facilitate common systemwide reporting.

Additionally, to ensure it adequately addresses CMS project quality and information security, the university should establish a quality management plan and continue its efforts to establish an effective quality assurance function for the CMS project. Such steps may include hiring an independent oversight consultant to perform various quality assurance functions and to evaluate the progress of the CMS project. The university should also establish a policy on sensitive information requiring that campuses implement the use of confidentiality agreements for all employees with access to the CMS system.

Finally, the university should plan future procurements to share project risk with vendors and consultants, such as allowing them to propose their own solutions and structuring contracts to protect the university's interest, including provisions to pay only after deliverables have been tested and accepted.

***University Action: Partial corrective action taken.***

The university stated that it established a practice to record the actual hours spent to develop modifications and that it will use the data for ongoing maintenance decisions and planning future upgrades. Additionally, it stated that in the requirement development phase of future projects, it will consider the impact of current business processes on vendor selection before procuring IT solutions or software when best practices warrant such a review and that it implemented a policy that requires this consideration of business processes related to vendor selection. Further, in response to our recommendation to reassess the design of CMS, the university indicated that it would evaluate the economies and benefits that could be achieved by alternative technology approaches.

It stated that it would solicit contractors for this assessment by December 2003. The university also stated that it defined and published the scope of the CMS baseline core functionality and that campuses will report costs based on this baseline core functionality, as well as report on the cost of planned functionality outside of this baseline. The university indicated it would adjust campus projections to reflect changes in campus implementation plans. The university stated that by December 2003 it would evaluate the opportunity for improvements in systemwide reporting using CMS and develop documentation for each area of systemwide reporting to identify the data required, the source of the data, the edits useful for quality assurance, and the schedule for data submissions.

The university also stated that it implemented a quality assurance function for CMS releases and is developing a quality assurance plan. Further, the university indicated that although it has conducted internal discussions on the need for oversight consulting on CMS, that by the end of October 2003, it would complete its determination of best practices in higher education regarding independent oversight consultants. The university also stated that it issued policy and a letter to campus presidents related to protection and control of confidential data, including the required use of confidentiality agreements. It indicated that it was collaborating with the software vendor to improve access security in the base software product and expected completion in late fall 2003. Finally, the university asserted that it would continue to use risk sharing with vendors when circumstances are consistent with industry best practices and when marketplace conditions make such an approach feasible, appropriate, and cost-effective. Additionally, it stated that it will revise its policies regarding risk sharing to comply with any new legislation and to provide the assurance of change we recommended in our letter to the chancellor in May 2003.

**Finding #4: The processes the university used to select the software vendor and consultants on the project did not clearly demonstrate best-value procurements.**

The university's process to select the software vendor and consultants for the CMS project did not clearly demonstrate best-value procurements that consider both quality of proposals

and overall costs. For example, the procurement process by which the university selected a single CMS software vendor raises questions about whether the university used a fair and objective competitive process. Specifically, its solicitation document did not provide for a method to select only one vendor, although the university decided late in the process that it needed such a method. Moreover, when the selection narrowed to two vendors, the university did not formally modify the procurement process nor use quantitative scoring to select a best-value vendor objectively. Likewise, the university could not demonstrate that it resolved issues that the procurement evaluation teams raised for the software ultimately selected. The university also could not show us how it determined that the cost differences between the competing vendors were immaterial. Further, the university's analysis comparing the finalist vendors' costs did not compare costs for a systemwide implementation and was based on a fraction of the actual maintenance and operations costs now estimated.

Additionally, the university's practice of employing consultants to work on the CMS project without appropriate competition raises more questions about the propriety of its business dealings. For instance, the university hired consulting firms under sole-source contracts for reasons that appear questionable. Further, although it recommends a discussion with consulting firms about scope of work and rates, the university does not require the solicitation of offers from more than one prequalified consultant with university-awarded master agreements. As a result, the university has not always solicited offers from multiple prequalified consultants before procuring their services and, therefore, cannot demonstrate that it procured best-value services.

To ensure it uses recommended practices in its future procurements, the university should use the procurement process appropriate to the procurement objective, restarting the process or formally modifying the process through written notification to vendors as the objectives change. The university should also establish a practice of using quantitative scoring to clearly demonstrate that it followed an objective evaluation process to identify the best-value vendor. It should also document the resolution of evaluation team concerns to demonstrate that it considered and addressed or mitigated these concerns. Finally, the university should enforce its policy that prohibits the use of sole-source contracts when multiple

vendors or consultants are available and establish a policy for the use of its master agreements to require the solicitation of offers from at least three prequalified vendors or consultants.

***University Action: Partial corrective action taken.***

The university stated that it issued a bulletin reminding campuses to use the procurement process appropriate to the procurement objective. Additionally, it indicated that it modified existing policies to require the use of quantitative scoring to identify the best-value vendor. However, although previously the university stated that it would further review its procedures for the resolution and documentation of concerns arising during evaluation processes, its September 2003 update did not address this topic. Further, the university stated that it reissued its sole source policy and guidance to campuses and revised and reissued its policy and guidelines for master agreements requiring campuses to solicit at least three offers when using these agreements.

**Finding #5: Data center services have improved, but data warehousing needs remain.**

Unlike its procurement of the CMS software, the university did use recommended procurement practices to select the outsourced data processing services needed to run CMS. The university conveyed its needs to potential vendors, asking them to propose solutions. The university also used an objective selection process with weighted criteria to evaluate potential vendors. Further, the university shared risk with the vendor by establishing contract terms aimed at holding the vendor accountable for meeting preestablished service levels. When it experienced inadequate service from the data center in the early months of the contract, the university used the procedures outlined in the contract to help raise the data center services to agreed levels. The service levels have improved in recent months, with the vendor achieving or coming within one percentage point of achieving targets in the five months ending in November 2002.

Although the university worked to address its CMS data processing needs and is implementing more efficient means for reporting, it only now is starting to address campus CMS data storage and retrieval (data warehousing) needs. The outsourced data center processes CMS transactions, but is not designed for data warehousing. Data warehousing can provide for optimum

data storage and reporting, such as enabling the production of reports that contain historical analysis of university operations. Largely because of concerns over CMS project resources, the university reportedly removed data warehousing from the CMS project scope early in the project and made this important component a campus responsibility, not including the costs as part of its CMS project costs. Now, with some campuses expressing an interest in data warehousing services, the university is addressing the data warehousing needs for a voluntary consortium of campuses and expected to release its final version of the data warehousing model in early 2003.

To ensure it continues to receive improved service levels from the data center vendor, the university should continue to monitor and take action to resolve problems with the vendor. The university should also ensure that it provides campuses with the means to effectively and efficiently store and retrieve data needed for management reporting by expediting the CMS data warehousing project, and it should include the CMS-related costs of data warehousing in its CMS project costs.

***University Action: Partial corrective action taken.***

The university stated that it would continue to monitor and manage the performance of the CMS data center and take appropriate and prompt action to assure appropriate service levels. Further, it indicated that it is in the process of determining the feasibility of data warehousing for the CMS project. The university stated that by December 2003 it would define the requirements for data warehousing on campuses and systemwide as a beginning step to a feasibility study regarding data warehousing as part of the CMS project.

**Finding #6: The university's oversight over potential conflicts of interest needs improvement.**

The university did not do enough to detect or prevent conflicts of interest by decision makers for CMS-related procurements. It did not identify all necessary employee positions in its conflict-of-interest code as designated positions required to file annual statement of economic interest forms (Form 700s) and did not always retain and make available certain required filings of these forms. Additionally, the university did not require consultants on the project to file Form 700s, although they performed duties similar to employees in designated positions. Further, the

university failed to provide for adequate disclosure processes to help ensure that individuals participating in the procurement process were free from conflicts. Also, it did not provide appropriate guidance to employees to identify potential conflicts using the Fair Political Practices Commission (FPPC) process for determining conflicts. Finally, it lacks a policy that spells out for university employees what constitutes “incompatible activities,” such as accepting anything of value from anyone seeking to do business with the university, and does not require that employees in designated positions receive regular ethics training.

Our review of Form 700s found an employee who appeared to have a conflict of interest while participating in the CMS software procurement decision and an employee who possibly may have used nonpublic information to benefit personally. Conflicts of interest cast a shadow over the university’s reputation for fair and honest business practices and undermine public confidence in the university’s procurement decisions. Moreover, if an employee uses information not available to the general public for personal financial gain, it not only harms the university’s reputation but also is unlawful.

To ensure that the university takes appropriate action to prevent potential conflicts of interest in the future, the Legislature should consider requiring the university to provide periodic ethics training to designated university employees similar to that required by the Government Code for designated state employees. Additionally, the Legislature should consider requiring the university to establish an incompatibles activities policy for university employees similar to that addressed in Government Code, Section 19990.

Similarly, the university should conduct periodic conflict-of-interest training, such as the ethics training required of state agencies for designated employees, and should establish an incompatible activities policy that it communicates to university employees. The university should also enhance its disclosure form to indicate what constitutes a conflict, identify all participating vendors, and state the prohibition of using nonpublic information to benefit personally; and it should require all employees to sign this form before participating in the procurement process. Additionally, the university should update its conflict-of-interest code to classify all positions responsible for evaluating or overseeing vendors or consultants and should require consultants that serve in a staff capacity

and that participate or influence university decisions to file Form 700s. Further, university human resources staff should be reminded of their responsibility to collect, retain, and make available filed Form 700s for the required seven-year period. Finally, the university should remind its employees of the prohibition against using information not available to the public to benefit financially, and discipline infractions if necessary.

***Legislative Action: Legislation proposed.***

The Legislature introduced and amended Senate Bill 971 which, among other items, would require the university to offer to each of the university's designated employees, on at least a semiannual basis, an orientation course on the relevant employee ethics statutes and regulations that govern official conduct. Additionally, the Legislature introduced and amended Assembly Bill 491, which, among other items, would require the university to develop guidelines for IT projects that are consistent with Section 19990 of the Government Code. Both bills were placed on inactive status in September 2003.

***University Action: Partial corrective action taken.***

The university stated that by December 2003 it would develop a comprehensive web-based conflict-of-interest and ethics training program for delivery to designated employees who will be required to certify completion of the training. The training includes coverage of the Fair Political Practices Commission (FPPC) eight-step process for assessing potential conflicts and employees' responsibility to seek the advice of counsel when questions exist. Additionally, the university stated that it presented a workshop in February 2003 to update university filing officers on the FPPC filing requirements and that its counsel reviewed conflict-of-interest issues and would fully cooperate with any action taken by the FPPC. The university also indicated that it distributed a memorandum identifying key laws that govern the behavior and activities of university employees in areas of incompatible activities, conflict of interest, and ethics.

The university stated that it revised and reissued requirements for procurement disclosure forms. The university reported it enhanced its procurement disclosure form to clearly indicate what constitutes a conflict of interest and state that evaluators are prohibited from using

nonpublic information to benefit personally. Further, the university stated that it would ensure that all participants understand the scope and nature of their commitments when participating in a procurement activity, and that, when possible, it would list on the disclosure form all vendors participating in the procurement. It also stated that it advised university officials to review carefully the existing designated position list to determine whether existing positions require incorporation and stated that in determining its designated positions, filing officers would identify employees in positions responsible for evaluating and overseeing vendors and contractors. It further indicated that it would require consultants to file Form 700s when they are hired to make or participate in making decisions that foreseeably will have a material effect in a university financial interest. The university asserted that it reminded filing officers in February 2003 of the requirement to collect, retain, and make available for the required seven-year period the filed Form 700s and that it would repeat this reminder each year. Finally, the university indicated that the memorandum identifying key laws that it distributed addresses the prohibition against employees using information not available to the public to benefit financially.



# STATEWIDE PROCUREMENT PRACTICES

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## ***Proposed Reforms Should Help Safeguard State Resources, but the Potential for Misuse Remains***

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### ***Audit Highlights . . .***

*Our review of the State's procurement practices revealed the following:*

- Until the governor's May 2002 Executive Order, departments did not compare prices among California Multiple Award Schedule vendors.*
  - Inadequate oversight by the Department of General Services (General Services) contributed to the problems we identified with departments' purchasing practices.*
  - Without comparing prices, the State purchased millions in goods and services for the Web portal from vendors that played a role in defining the approach and architecture for the project.*
  - Estimated Web portal project costs given to administrative control agencies and the Legislative Analyst's Office were sometimes inaccurate.*
  - Before the Executive Order, departments frequently misused alternative procurement practices—sole-source contracts and emergency purchases.*
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**REPORT NUMBER 2002-112, MARCH 2003**

**Department of General Services and the Stephen P. Teale Data Center responses as of September 2003**

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to audit the California Multiple Award Schedule (CMAS) program and the State's sole-source contracting procedures. Specifically, the audit committee asked that we review the process used by General Services when establishing the CMAS vendors list and the procedures and practices used to identify qualified contractors and consultants when using noncompetitively bid and CMAS contracts to procure goods and services. The audit committee also asked us to include in our review procurements related to the state Web portal.

### **Finding #1: Departments largely ignored recommended procedures for purchasing from CMAS vendors.**

Our review of CMAS purchases made by nine state departments revealed that, before May 2002, when an Executive Order called for wholesale changes in the State's procurement practices, few departments took prudent steps, such as comparing prices, to ensure that they obtained the best value when acquiring goods and services from CMAS vendors. For example, largely at the request of two former officials of the Governor's Office, the Department of General Services (General Services), the Stephen P. Teale Data Center (Teale Data Center), and the Health and Human Services Data Center purchased more than \$3.1 million in goods and services for the state Web portal from one CMAS vendor without comparing prices or using some other means to determine that the selected vendor provided the best value to the State. Additionally, General Services and the Teale Data Center purchased items for the Web portal totaling \$690,000 that were not included in the vendors' CMAS contract.

Recent changes to the CMAS requirements have slowed but not halted departments' misuse of the CMAS program. Specifically, departments did not obtain at least three price quotes, as required, for two of the 25 CMAS purchases made after the date of the Executive Order.

In order to ensure that the State receives the best value when acquiring goods and services, we recommended that departments stress adherence to all CMAS requirements and reject requested purchases if these requirements are not met. Additionally, departments should review the appropriate CMAS contract to ensure that the requested good or service is included in the contract.

***General Services' Action: Corrective action taken.***

According to General Services, former Governor Gray Davis' Cabinet Secretary and Deputy Chief of Staff and the former Director of the Department of Finance jointly issued a memorandum to all departments notifying them that General Services' comprehensive training program for state contracting and procurement professionals is mandatory. The memorandum also encouraged all departments to review their procurement and contracting operations to ensure that all activities within these programs are conducted in compliance with requirements. These requirements are discussed most recently in a management memo issued by General Services on May 28, 2003, that establishes strict requirements for procuring goods and services through the use of CMAS and non-competitively bid acquisition methods.

**Finding #2: The State's failure to compare prices created the appearance that some companies may have had an unfair advantage in selling Web portal components to the State.**

The Web portal was developed with guidance from a group of executives from several private businesses, some of which later sold products for the project. Members of this group, called the Web Council, gave their "unanimous blessing to the portal's conceptual approach and its specific architecture." According to the minutes and agendas from Web Council meetings, representatives of several companies participating in the council made presentations to discuss their companies' products. Three of these companies ultimately sold hardware

and software components to the State for the Web portal totaling \$2.5 million. These companies sold their products to the State, either directly or indirectly through resellers with CMAS contracts. The concept of obtaining guidance from industry experts is meritorious if, after obtaining the guidance, the State engages in an open, competitive procurement process. However, if obtaining advice from industry experts is followed by procurement of their goods or services without comparing prices to those offered by others, as was the case with numerous CMAS purchases for the Web portal, an appearance of unfairness is created.

In September 2002, the Teale Data Center assumed responsibility for providing management, maintenance, and support for the Web portal project. To ensure that the State's investment in the Web portal is a prudent use of taxpayer resource, it should use the competitive bidding process for purchasing goods and services for the project.

***Teale Data Center Action: Corrective action taken.***

Teale Data Center regularly utilizes General Services' contract registry to seek competition. Further, it is standard Teale Data Center practice to exceed the minimum number of bids required for informal bids as this practice ensures diverse vendor participation. Finally, as the existing Web portal services and maintenance contracts required renewal, Teale Data Center has competitively bid all subsequent new contracts.

**Finding #3: General Services and former officials of the Governor's Office did not follow state policy governing information technology projects.**

General Services—the administrator of the Web portal project—failed to obtain the necessary approvals from the former Department of Information Technology (DOIT) and the Department of Finance (Finance) before significant changes were made to the Web portal project. The changes, which increase previously approved project costs by 94 percent, were made at the direction of the former director of eGovernment. Among the changes, estimated to cost \$9.2 million, were significant enhancements related to the energy crisis and terrorist threats and ongoing maintenance provided by consultants rather than state personnel, as was originally planned. General Services submitted a special project report to DOIT and Finance explaining the reasons

for the increased cost and seeking approval for the enhancements. However, the enhancements were completed four to six months before General Services submitted the report.

Additionally, General Services did not adequately coordinate and monitor Web portal purchasing and reporting activities. As a result, the special project reports submitted to DOIT, Finance, and the Legislative Analyst's Office (LAO) did not accurately account for all Web portal purchases. Specifically, at least one special project report that General Services submitted was inaccurate because it did not include more than \$1.3 million in Web portal costs incurred by its Telecommunications Division and the Health and Human Services Data Center. According to the former chief of General Services' Enterprise Business Office, only costs that were under her control were reported to the individual preparing the special project reports.

Finally, it appears that responsible officials at General Services were unaware that a revised Web portal project report, which nearly doubled the estimated cost of the project, had been submitted to DOIT, Finance, and the LAO reflecting a significant increase in total project costs. According to officials at Finance, they met with former officials of the Governor's Office and representatives from General Services to discuss the proposed cost increases. The officials at Finance stated that it is not uncommon for minor modifications to be made to a special project report after it has been submitted for approval. However, we believe that changes to a project that effectively double the estimated cost of the project do not constitute minor modifications. Moreover, Finance could not provide any documentation of its analysis of the proposed project changes and resulting cost increase. Nevertheless, it approved submitting the revised estimates to the Legislature based on available information, given the high priority of the project.

To ensure that Web portal costs are properly accounted for, the Teale Data Center should monitor project expenses by recording estimated costs when contracts and purchase orders are initiated and actual costs when paid. The Teale Data Center should also submit special project reports to Finance and the LAO when required and ensure that reported costs accurately reflect actual expenditures and commitments to date. Finally, the data center should make certain that special project reports contain estimates for at least the same number of years that earlier reports cover so that reviewers can easily identify changes in the overall projected costs.

***Teale Data Center Action: Corrective action taken.***

The Teale Data Center's administrative processes require an internal analysis and approval of estimated costs prior to the initiation of the bidding process. If the resulting procurement activity results in costs that exceed the original estimate, approval is required before acquisition can be completed. Teale Data Center's Finance Division has developed a spreadsheet used to monitor projected versus actual expenditures. Should requests for acquisitions vary from the original plan, they are analyzed to determine the reason for the change and if it is within budget authorization prior to the expenditure being made. The spreadsheet is updated monthly and is shared with the manager of the Web portal and the assistant director of the Enterprise Division.

Furthermore, the Teale Data Center will continue to submit special project reports to the Department of Finance and the Legislative Analyst's Office, when required, which will accurately reflect all costs for the Web portal. Finally, the Teale Data Center will ensure that any future special project report and feasibility study report have consistent reporting periods.

**Finding #4: The use of multiple departments to make purchases for the Web portal resulted in payments for services that were required under earlier agreements.**

Several departments made Web portal purchases rather than one office coordinating and making all purchases. Consequently, no one office carefully tracked existing purchases and compared them to newly requested purchases, and the State contracted for some services even though the same services had already been required under earlier agreements. For example, General Services' Telecommunications Division issued a \$173,000 purchase order to a consulting firm for project management of ongoing operations and maintenance of the Web portal. However, the terms and services of this contract duplicated some of the terms and services of another purchase order that General Services' Enterprise Business Office had previously issued to the consulting firm.

Similarly, the Health and Human Services Data Center entered into a \$246,000 agreement with a consulting firm to create a plan to develop a Web portal mirror site. In reviewing the three reports that the consulting firm submitted in fulfillment of its

agreement with the Health and Human Services Data Center, we found that the content of the reports was information the consulting firm was already obligated to provide under an earlier contract with General Services.

General Services should review past payments to the consulting firm and another vendor by General Services, the Health and Human Services Data Center, and the Teale Data Center to ensure that the State has not paid for goods or services twice. If duplicate payments were made, General Services should recover them.

***General Services' Action: Corrective action taken.***

General Services reviewed the transactions in question and concluded that duplicate payments did not occur.

**Finding #5: Recent actions by General Services and the Teale Data Center have reduced Web portal costs.**

According to the most recent special project report, jointly submitted by General Services and the Teale Data Center, total estimated costs of the Web portal were nearly \$6 million less than previously reported. The reduced costs were largely due to cutbacks in Web portal maintenance that included a major reduction in the number of hours for the consulting firm to maintain the portal.

In June 2002, the interim director of DOIT stated that the consulting firm's Web portal agreements were expensive and little had been done to transfer the consulting firm's expertise to state employees so that a state department could ultimately operate the portal. He recommended that General Services extend the consulting firm's contract until a competitively selected contractor became available. He also recommended reducing the size of the contract by restricting the consulting firm's role to limited maintenance and knowledge transfer functions, ultimately turning over the maintenance of the Web portal to state employees.

In January 2003, the Teale Data Center entered into a six-month contract with the same consulting firm for \$350,000 in Web portal maintenance. Unlike the manner in which previous maintenance contracts had been established, however, the Teale Data Center solicited proposals from 20 different companies and six firms responded. The Teale Data Center evaluated the responses and eventually chose the consulting firm, achieving

a 39 percent average reduction in the hourly rate over previous noncompetitively bid agreements with the firm. Therefore, the Teale Data Center should continue to use the competitive bidding process for purchases of goods and services for the project.

***Teale Data Center Action: Corrective action taken.***

The Teale Data Center strongly supports the competitive bid process and has competitively bid all new contracts for the Web portal.

**Finding #6: State departments improperly used sole-source contracts and emergency purchase orders.**

Before the May 2002 Executive Order, state departments often did not adequately justify the need for sole-source contracts. Requests for sole-source contracts were often ambiguous or failed to demonstrate that the contracted good or service was the only one that could meet the State's needs. In addition, because they failed to make sufficient plans for certain purchases, departments often used sole-source contracts inappropriately. We reviewed 23 requests for sole-source contract approval submitted by various departments and found eight examples of departmental misuse of this type of exemption. General Services, however, approved all 23 requests. In four requests that General Services approved, the departments failed to provide the kind or degree of justification we expected to see. We could not determine whether the circumstances warranted a sole-source contract for one of the 23 requests because the department's justification was ambiguous. Finally, in three of the 23 sole-source requests, the departments sought the contracts because they failed to properly plan for the acquisition and, as a result, did not have time to acquire the goods or services through the normal competitive bidding process.

Similarly, departments frequently misused the State's emergency purchasing process by failing to meet the legal requirements for this type of procurement. For 17 of the 25 purchase requests we reviewed, the departments were requesting emergency purchases. In the remaining eight cases, the departments were requesting approval for reasons other than meeting emergency needs, such as seeking the purchase of items to meet special needs. Although General Services did not have the proper authority to grant exceptions for these purchases, it approved all eight.

Of the 17 emergency purchase requests totaling \$21.3 million, nine totaling \$2.3 million completely failed to identify the existence of an emergency situation that fell within the statutory definition or to explain how the proposed purchase was related to addressing the threat posed by an emergency.

State departments should require their legal counsel to review all sole-source contracts and emergency purchases to ensure they comply with statutes governing the use of noncompetitively bid contracts. Departments should also ensure that adequate time exists to properly plan for the acquisition of goods and services.

Moreover, General Services should require its Office of Legal Services to review all sole-source contract requests above a certain price threshold. General Services should also implement review procedures for sole-source contracts and emergency purchase orders to ensure that departments comply with applicable laws and regulations and require departments to submit documentation that demonstrates compliance. General Services should reject all sole-source and emergency purchase requests that fail to meet statutory requirements. Finally, General Services should seek a change in the current contracting and procurement laws if it wants to continue to exempt purchases from competitive bidding requirements because of special or unique circumstances.

***General Services' Action: Partial corrective action taken.***

General Services has implemented policies and procedures that provide for its Office of Legal Services to review all non-competitively bid contract requests that exceed \$250,000. Additionally, General Services has developed a form that requires detailed information be provided to justify non-competitively bid procurements. Specifically, the form requires departments to provide detailed responses for various issues, including (1) why the acquisition is restricted to one supplier, (2) background events that led to the acquisition, (3) the consequences of not purchasing the good or service, and (4) what market research was conducted to substantiate the lack of competition. Finally, General Services is working to enhance the form to provide additional assurance that non-competitive procurements are properly justified.

***Legislative Action: None.***

General Services is reviewing the need for additional exemption authority related to competitive bidding. At this time, a final decision has not been made on the need to pursue additional authority in this area.

**Finding #7: General Services needs to strengthen its oversight of state purchasing activities.**

General Services has provided weak oversight and administration of the CMAS program. We found that General Services, which is responsible for auditing state departments for compliance with contracting and procurement requirements, is not performing the audits required by state law. Specifically, between July 1999 and January 2003, General Services had completed only 105 of 174 required reviews. Moreover, less than one-half of the 105 reviews were completed on time.

Additionally, General Services does not sufficiently review CMAS vendors to ensure that they comply with the terms of their contracts with the State. For instance, from July 1998 through September 2002, General Services had only reviewed 29 of 2,300 active CMAS vendors. Perhaps more importantly, General Services does not always make sure that other state and local government contracts on which CMAS contracts are based are, in fact, awarded and amended on a competitive basis. As a result, the State may be paying more than it should for the goods and services it purchases. Finally, General Services does not consistently obtain and maintain accurate data on departments' CMAS purchases. Consequently, it is sometimes charging other state departments more than it should for administrative fees. For example, we reviewed 90 CMAS purchases at nine departments and found 24 instances in which General Services had either entered the incorrect amount in its accounting system or had no record of the transaction. We further reviewed 10 of the 24 transactions and determined that General Services had overcharged departments more than \$219,000.

We recommended that General Services implement the recommendations made by the Governor's Task Force on Contracting and Procurement Review (task force), which include increasing the frequency of audits and reviews of state departments. General Services should consider reducing or eliminating the delegated purchasing authority of departments that fail to comply with contracting and procurement

requirements. Additionally, General Services should increase the frequency of its reviews of CMAS vendors and ensure that processes established by other governmental entities for awarding and amending contracts are in accordance with CMAS goals. Finally, General Services should consult with departments to determine what can be done to facilitate monthly reconciliation of CMAS purchasing and billing activities.

***General Services' Action: Partial corrective action taken.***

General Services is committed to fully addressing the recommendations contained in the task force's report and is continuing to assign significant resources to that activity. For instance, General Services has initiated a cornerstone of the procurement reform effort—the training of state procurement officials. General Services has also implemented a system to track the volume and type of state procurement contracts. As a result, the State is now able to capture, through an internet-based system, data on all significant purchases on a near-real time basis. General Services has also facilitated meetings with the Department of Finance and departmental internal auditors to revise existing audit procedures to include CMAS and non-competitively bid contracts. Further, General Services is considering limiting its audits and reviews of some departments to an evaluation of the adequacy of the departments' most recent internal reviews. General Services noted that compliance with purchasing and contracting requirements is a major part of maintaining approved purchasing authority. If these requirements are not met, purchasing authority will be reduced or eliminated.

Although implementing a program that results in an increase in the frequency of vendor reviews is a priority, the State's current budget situation limits General Services' ability to obtain and assign additional resources to this activity. In the interim, General Services is focusing its limited resources on the review of the most frequently used CMAS suppliers. Finally, General Services believes that the implementation of a mandatory statewide electronic procurement system that would enable them to capture actual department purchasing activity in real time is the ultimate solution to its billing challenges. While General Services recognizes the importance of such a system, it is not feasible in the current fiscal environment. As an interim corrective action, General Services issued a memorandum to its customer departments advising them of the importance of regularly reconciling their purchasing information with invoices.

**Finding #8: Although task force recommendations address most weaknesses, some cannot be immediately implemented and others are needed.**

In August 2002, the task force recommended 20 purchasing reforms, completing its directive from the governor's Executive Order issued on May 20, 2002. The recommendations, which focus on the use of the CMAS program and noncompetitive bid contracts, call for comprehensive changes in the State's contracting and procurement procedures. Prompted by the controversy surrounding the Oracle enterprise licensing agreement, the governor asked the task force to review the State's contracting and procurement procedures and recommend the necessary statutory, regulatory, or administrative changes to "ensure that open and competitive bidding is utilized to the greatest extent possible." The task force's recommendations include the following:

- Departments must compare prices among CMAS vendors.
- Acquisitions of large information technology projects using CMAS contracts and master agreements should be prohibited unless approved in advance.
- General Services needs to establish specific criteria to qualify piggybacking vendors.<sup>1</sup>
- General Services should increase the frequency of its compliance reviews of purchasing activities of state departments.
- General Services should implement a new data integration system to address deficiencies in its ability to capture data and report on contracting and procurement transactions.

In general, we believe the task force's recommended changes, if properly implemented, should address many of the weaknesses in the CMAS program and noncompetitive bidding procedures we identified in our report. However, we believe that additional steps should be implemented based on the results of our audit. For example, General Services should revise its procedures for awarding contracts to vendors based on contracts they hold with other government entities because it often awards CMAS contracts without adequately evaluating the competitive-pricing processes that other state and local governments use to award base contracts.

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<sup>1</sup> Vendors that do not have an existing federal multiple-award schedules contract but obtain a CMAS contract by agreeing to provide goods and services on the same terms as vendors that do have a multiple-award contract through the federal or some other government entity, are commonly referred to as piggyback contracts.

General Services also needs to develop classes that provide comprehensive coverage of sole-source contracts, emergency purchases, and CMAS contracts, and departments need to ensure that affected personnel attend the classes periodically. Also, because most of the departments we surveyed indicated they had experienced problems working with CMAS vendors, General Services should also consider holding periodic information sessions with the vendors. Further, in addition to implementing a new data integration system, which both General Services and the task force acknowledge is a long-term solution, we believe General Services should work with departments to establish a process to reconcile their purchasing information with invoices and reports prepared by General Services. Such reconciliation would allow departments to report and correct errors to General Services, thereby preventing incorrect billings and increasing the reliability of purchasing data. Finally, to increase departments' ability to access online information about the CMAS program, General Services should explore the possibility of including copies of vendor contracts on its Web site.

***General Services' Action: Partial corrective action taken.***

General Services is continuing to focus additional efforts on obtaining further assurance that processes used by other government entities to execute contracts are in accordance with CMAS goals. As part of this process, General Services has developed and implemented written policies and procedures that more clearly address this activity. Specifically, the CMAS analyst, through a review of documents and conversation with the awarding entity, must ensure that the process used by the awarding entity meets the State's standards for solicitation assessment.

As previously discussed, General Services has begun training of state procurement officials. In conjunction with the California State University at Northridge's Center for Management and Organization Development, General Services conducted an extensive survey of individuals involved in state purchasing activities. Based on this data, General Services is phasing in a series of new state acquisition courses. The first classes within General Services' comprehensive training and certification program were held on April 30, 2003. Additionally, the first classes within General Services' 64-hour Basic Certificate Program began on October 7, 2003.

Finally, according to General Services, while its Web site does provide a search tool by which departments can identify CMAS contracts by the categories of goods and services provided, departments are not able to access line-item detail on-line. Implementing a detailed catalog containing CMAS goods and services requires implementation of a comprehensive electronic procurement system. A dynamic software and hardware solution will be required to support the CMAS program, which has over 2,300 active contracts and more than 1,600 suppliers. At this time, the State's budget situation prevents the pursuit of this complicated and costly project.



# HEALTH AND HUMAN SERVICES AGENCY DATA CENTER

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## ***Investigations of Improper Activities by State Employees, August 2002 Through January 2003***

ALLEGATION I2002-652 (REPORT I2003-1), APRIL 2003

Health and Human Services Agency Data Center's response as  
of July 2003

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### ***Investigative Highlights . . .***

*A former manager of the  
Health and Human Services  
Agency Data Center  
(data center) engaged in  
the following improper  
governmental activities:*

- Negotiated employment  
with a company while  
he was in a position to  
influence a \$345,000  
contract between the data  
center and that company.*
  - Drafted contract  
language that was  
incorporated into the  
contract between the data  
center and a company  
that he began working  
for one business day after  
ending his employment  
with the State.*
- 

**W**e investigated and substantiated an allegation that a manager of the Health and Human Services Agency Data Center (data center) violated conflict-of-interest laws. Our investigation showed that work the manager performed influenced the formation of a \$345,000 contract between the data center and company 1, a private corporation that the manager negotiated for employment with while he was in a position to influence the contract.

### **Finding: A manager violated conflict-of-interest laws.**

The manager was both directly and indirectly involved in the contract with company 1. Specifically, while he was employed at the data center, the manager drafted the statement of work that was incorporated as part of the contract between the data center and company 1, a private consulting firm the manager began to work for one business day after ending his state employment. The statement of work describes the State's and contractor's responsibilities, contract duration, tasks for the contractor to perform, payment methods, and other provisions.

The manager was also indirectly involved in creating the contract between the data center and company 1 because he prepared documents that data center staff ultimately relied on to establish the contract. We also substantiated that while he was employed at the data center, the manager negotiated for employment with company 1. State law prohibits employees from having a financial interest in any contract they make in their official capacity. Further, the cost to the State for the

manager's services as a consultant was more than three times the previous cost of his state salary and benefits, despite the fact that the manager's duties were essentially the same.

***Data Center Action: Partial corrective action taken.***

The data center has referred our findings to the Fair Political Practices Commission and the attorney general for evaluation of the alleged violations of conflict-of-interest laws. The data center also requested a review by the Department of Personnel Administration to determine whether it should take adverse action against employees who may have aided or assisted the manager. Further, the data center has provided mandatory in-service training to educate key employees involved in the procurement process and their responsibilities under state laws.

# STATE CONTROLLER'S OFFICE

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## ***Does Not Always Ensure the Safekeeping, Prompt Distribution, and Collection of Unclaimed Property***

REPORT NUMBER 2002-122, JUNE 2003

State Controller's Office response as of December 2003

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### *Audit Highlights . . .*

*Our review of the State Controller's Office (controller), Bureau of Unclaimed Property (bureau), revealed the following:*

- The bureau's computerized Unclaimed Property System lacks sufficient controls to prevent unauthorized changes, and the duplication of account data, potentially resulting in the payment of fraudulent or duplicate claims.*
  - The bureau's manual tracking of securities is unreliable and the bureau is inconsistent in how quickly it sells securities.*
  - The bureau excludes more than \$7.1 million in unclaimed property from its Web site.*
  - The bureau does not consistently review and distribute claims in a reasonable amount of time.*
  - The bureau does not ensure that it receives all of the reported contents of safe deposit boxes.*
  - The controller's Financial-related Audits Bureau did not pursue an estimated \$6.7 million in unclaimed property from one holder.*
- 

The Joint Legislative Audit Committee (audit committee) requested that we evaluate the process used by the State Controller's Office (controller) Bureau of Unclaimed Property (bureau) for identifying unclaimed property from corporations, business associations, financial institutions, insurance companies, and other holders. Further, the audit committee asked us to determine whether the bureau distributes unclaimed property to eligible recipients accurately and in a timely manner. We were also asked to evaluate the bureau's process of safeguarding unclaimed property in its custody. Lastly, we were to determine whether the bureau evaluates claimant satisfaction, is responsive to complaints, and has a process in place to identify and implement corrective action.

### **Finding #1: Inaccurate data contained in the bureau's property system has resulted in the payment of fraudulent and duplicate claims.**

The bureau relies on its computerized Unclaimed Property System (property system) to track unclaimed property escheated to the State by persons and businesses holding unclaimed property (holders) and to disclose that the controller has the unclaimed property. However, the property system is not sufficiently reliable. Our primary concern is that the controller has not implemented controls to prevent bureau employees from making unauthorized changes to the system, despite knowing about this problem for eight months. Further, the property system does not generate reports that would reveal when unauthorized changes are made and by whom. These flaws allowed two student assistants to conspire to modify owner names in the data and allowed their accomplices to fraudulently claim some of the property.

Prior to 2002, the property system lacked effective controls to prevent duplicate data from being loaded into the property system. Although the controller took action to correct this weakness, as of May 6, 2003, the bureau had not yet removed all of the duplicate data from its property system. While the Information Systems Division reports it has taken action to prevent payments on properties listed on the duplicate reports, some of the properties are still on the bureau's Web site. Individuals using the Web site to determine whether the controller has their property may inadvertently conclude that they are owed more than the actual amount.

The bureau does not reconcile the total amount remitted for each holder report to the total of all the individual accounts loaded into the property system by that report. This may result in claimants not receiving funds to which they are legally entitled. In addition, the bureau's staff manually entered nearly 6,700 holder reports directly into the property system due to problems with a holder's electronically submitted reports. In doing so, the bureau bypassed most of the automatic system checks that could have identified errors in the data, such as checking for duplicate information. The bureau has established a procedure to verify the data in these records as claims come in, but it does not intend to verify all of the data entered directly into the property system.

To increase the reliability of the data in the property system, the bureau should do the following:

- Implement the programming changes necessary to ensure that employees cannot make unauthorized and unmonitored changes to the property system.
- Remove all duplicate account data from the property system.
- Ensure that both current and newly hired staff review unclaimed property accounts entered manually when claims are filed against the property to determine the accuracy of the data.

To ensure the accuracy of the data loaded into the property system, the bureau should require its staff to reconcile the total amount remitted by each holder to the total of all the individual records in the property system for that report.

***Controller's Action: Corrective action taken.***

The controller modified its property system to limit on-line property updates and to generate audit reports that allow supervisory review of any such on-line transactions. Additionally, the controller developed a plan to delete all the duplicate reports from the system, including modifying the property system to prevent the duplicate properties from appearing on the bureau's Web site.

Furthermore, the controller conducted training classes to ensure that all staff continues to adhere to current procedures for verification of claims filed for properties on the reports entered manually. The controller retrained staff on proper procedures for holder overpayments. Additionally, the controller made the necessary programming changes to fix system problems, including the development of a periodic report to identify any out of balance reports.

**Finding #2: The bureau may incorrectly bill holders for interest penalties.**

Inaccuracies in the property system may result in the incorrect billing of holders for interest penalties from which they should be exempt under the controller's amnesty program. Beginning in 2000, holders were allowed amnesty for their past failures to report unclaimed property on or before November 1, 1999, and were exempted from paying an interest penalty. However, the bureau did not include an amnesty indicator in the property system for all qualifying holder reports, and the controller has not modified its program that calculates interest penalties to exclude holder reports that were granted amnesty. The controller will have to correct both problems to avoid inappropriately billing the holders that it granted amnesty.

To prevent the billing of penalties for late reporting to holders granted amnesty, the controller should do the following:

- Identify reports covered by the amnesty program that do not currently have an amnesty indicator and add it.
- Modify its program that generates bills for interest penalties to exclude those reports with an amnesty indicator.

***Controller's Action: Corrective action taken.***

The controller reconciled all amnesty reports in the tracking system and the unclaimed property system. Further, the controller reviewed interest billings previously issued to verify that no erroneous billings were issued for approved amnesty reports. Additionally, the controller modified its procedures to ensure that all interest billings are reviewed and that no amnesty reports are incorrectly billed for interest. Lastly, the controller developed a plan for programming changes to prevent generating interest billings for approved amnesty reports.

**Finding #3: Although holder reports must be processed in order to account for property escheated to the State, thousands of holder reports await processing.**

To allow for the tracking and eventual disbursement of unclaimed property, the bureau must process the holder reports by loading the detailed owner data into the property system. Although the bureau must complete this process to be able to disclose on its Web site that it has the owner's property, to pay claims, to bill holders for interest due on late filings, and to reconcile the amounts reported by the holders to the amounts actually remitted by the holders, it told us that, as of June 5, 2003, it had not uploaded more than 8,500 holder reports, some as far back as 1996. More than 4,500 of these reports are less than one year old and are not considered a backlog.

During discussions with the bureau, we learned that two conditions contributed to its backlog of holder reports:

- Electronic reports in unreadable formats.
- Large increases in the number of holder reports submitted.

To enable the bureau to upload data reported in formats that it cannot access, it should do the following:

- Continue its efforts to contact the holders and request that they resubmit the owner data in the current reporting format.
- Consider contracting with an outside entity to read the remaining reports or to convert them into a usable format.

To allow for the timely notification to owners that the State has their property and the prompt billing of interest penalties, the bureau should ensure that it uploads holder reports within 12 months of receipt.

***Controller's Action: Corrective action taken.***

The controller completed its analysis of the backlogged reports and contacted the holders as necessary for any replacement media needed. Further, the controller developed alternatives for reading or converting any remaining reports, including options to contract with an outside firm, if necessary, to read or convert the data. Lastly, the controller developed a plan to process reports within a year of receipt.

**Finding #4: The bureau's tracking of securities in its custody needs improvement.**

Because the bureau cannot use the computerized property system to track changes in securities, it tracks these manually, increasing the probability of error and the number of staff needed to accommodate the workload. We found that the bureau's manual tracking of securities is unreliable and that the bureau is inconsistent in how quickly it sells securities. Moreover, because the bureau tracks securities by company name rather than by individual owner, when corporate actions such as stock splits result in the issuance of additional securities, the bureau does not consistently associate the new securities with the original securities. This results in securities for the same owner being sold on different dates for different prices, further complicating the bureau's reconciliation process, increasing both the potential for errors and the risk of allegations that the bureau has mismanaged owners' assets.

To eliminate the bureau's manual tracking of securities and dispel any impressions that it exercises judgment in deciding when is the best time to sell securities, thereby reducing the potential for errors, eliminating unnecessary work, and reducing the potential for litigation against the State, the controller should seek legislation to require it to sell securities immediately upon receipt. To ensure that the holders remit all of the reported securities, the bureau should compare the shares received to the shares reported by the holders, using the holder report summary sheets.

Alternatively, the controller should consider having holders deliver duplicates of the securities they have transferred into the controller's name to a specified broker authorized to accept them on the State's behalf. The controller should instruct and give the broker authorization to sell the securities immediately upon receipt. This may also require legislation. Additionally, the bureau should immediately sell all securities already in its custody.

If the bureau is unable to sell securities immediately upon receipt, it should do the following:

- Reconcile the securities remitted to the securities reported within one month of the receipt of the securities, for securities not already in its custody.
- Modify the property system to allow it to track all changes to securities, including the effective dates, receipts, sales, disbursements, and corporate actions, on an owner-by-owner basis. The bureau should ensure that it updates the property system to account for securities currently tracked in its manual ledgers. This process should be automated to allocate changes in the number of securities to the affected accounts with minimal human intervention.
- Sell all securities related to a particular account within two years of the initial receipt, regardless of corporate actions. Additionally, the property system should be modified to generate a monthly report to alert the bureau to securities approaching the two-year deadline for sale, regardless of the timing of corporate actions.

In either case, the bureau should do the following:

- Review all of its manual ledgers to ensure that it has accurately recorded all corporate actions, receipts, sales, and disbursements of securities. Once this review is complete, the bureau should discontinue the use of its manual ledgers.
- Complete its reconciliation of the securities remitted to the securities reported for all securities not previously reconciled.

***Legislative Action: None.***

Although the controller did not seek legislation to require it to sell securities immediately upon receipt, as discussed in the following paragraph it did address the issue internally.

***Controller's Action: Corrective action taken.***

The controller directed staff to immediately sell securities received with holder reports. Further, the controller developed a plan to accelerate the sale of securities currently in house. Additionally, the controller reviewed options to streamline the process of escheating securities to facilitate the more immediate sale of securities. Future contracts with third-party contractors include a requirement that securities be delivered to the controller-contracted broker for immediate sale. The controller created standardized procedures for making entries into the security ledgers to improve consistency of entries in the ledgers, including a quality review of the entries. Additionally, the controller developed a plan to improve the timeliness of reconciling the remitted securities to reported securities.

**Finding #5: Property belonging to governmental agencies and some private entities are excluded from the bureau's Web site.**

We also found that the bureau excludes a large amount of unclaimed property reported to it for federal and state departments, local governments, schools and school districts, other states, and some private entities from its Web site. As of April 30, 2003, the bureau held more than \$7.1 million in unclaimed property for various entities that it has not posted on its Web site. Even if the entities check the Web site to see if the State has some of their property, they would erroneously conclude that it does not.

To fully inform all entities that it has their unclaimed property in its possession, the bureau should do the following:

- Discontinue excluding any properties from its Web site.
- When it receives unclaimed property belonging to any governmental entity, notify that entity. If it does not receive sufficient information to determine which governmental entity the property belongs to, it should seek additional information from the holder.

***Controller's Action: Corrective action taken.***

The controller issued instructions to holders in writing and through the Web site of their responsibilities to notify owners prior to the escheatment of accounts. Additionally,

the controller discontinued its practice of excluding government properties from its Web site. Further, the controller developed a plan to notify government agencies of potential unclaimed properties in excess of \$1,000 on an annual basis and simplified the process for transferring property to them.

**Finding #6: The bureau does not approve and distribute claims in a timely manner.**

The Unclaimed Property Law (law) requires the bureau to consider each claim for the return of property within 90 days after it is filed and to provide written notice to the person claiming the property (claimant) if the claim is denied. Although the law does not specifically require the bureau to approve or deny claims within 90 days, we believe that once the claimant has provided all required documentation, 90 days is a reasonable amount of time for the bureau to either approve or deny the claim. However, the bureau does not consistently do so. Claims for securities generally take longer to review and to distribute to the claimant than claims for most other types of property. Lastly, although the bureau has received numerous complaints regarding the timely distribution of claims, it has not streamlined the claim distribution process.

To ensure that it distributes assets to bona fide claimants in a timely manner, the bureau should do the following:

- Review all claims and either approve or deny them within 90 days of receipt.
- Distribute assets on approved claims within 30 days of approval.

***Controller's Action: Corrective action taken.***

The controller identified means of streamlining the approval of claims by increasing the threshold for applying its streamlined claim approval process from \$1,000 to \$5,000. Additionally, the controller created a new unit to process unclaimed property claims from heirfinders and investigators.

**Finding #7: The bureau does not compare the contents of safe deposit boxes it receives to the holder-prepared inventories.**

To determine the adequacy of the bureau's safekeeping of the contents of safe deposit boxes, we reviewed a sample of 32 safe deposit boxes. We expected that the bureau's inventories would conform materially to the holders' inventories; however, we found that the bureau does not reconcile the holders' inventories to its own inventories or to the boxes' contents to ensure that it has received all of the property listed. Instead, the bureau creates its own inventories from the contents actually received and usually disregards the holder inventories. The bureau's process of creating its own inventories results in unnecessary work and does not ensure that it has received all of the reported contents of the safe deposit boxes. If the bureau compared the contents received to the contents reported by the holder, it would be able to identify any missing property and take prompt action to request that the holder either explain the difference or remit the missing property. Doing so would reduce its liability for items that were not remitted by the holder.

To ensure that it has properly accounted for all of the owners' properties, the bureau should develop a standard inventory form for holders to use to report the contents of safe deposit boxes and for the bureau to use to verify that it has received all of the reported contents from the holders. This standard form should include a section for the bureau to indicate its receipt of all of the reported contents, the date of review, and any follow-up required for contents that were reported but not remitted by the holder.

***Controller's Action: Pending.***

The controller will develop and implement the necessary forms, instructions, and procedures.

**Finding #8: Although state law allows the bureau to auction the contents of safe deposit boxes, it did not auction property for almost two years.**

The law allows the bureau to sell the contents of safe deposit boxes in its custody to the highest bidder at public sale, including sales via the Internet. Although the bureau is not required to sell the contents of safe deposit boxes, failure to do so results in higher costs to the State to store and safeguard those contents. The floor of the bureau's vault is crowded with the safe deposit box contents it has received from holders but has not sent to

storage, and its shelves are overflowing with binders and the bagged contents of safe deposit boxes. We found that the bureau had not conducted an auction for almost two years, resulting in the overcrowding of its safe deposit box vault with the contents of safe deposit boxes that it has received from holders.

To reduce the overcrowding in its safe deposit box vault, the bureau should conduct an auction of the contents of safe deposit boxes at least monthly.

***Controller's Action: Partial corrective action taken.***

The controller completed a pilot project for conducting on-line Internet auctions of safe deposit box contents. Further, the controller implemented an ongoing on-line auction using new procedures and system updates to verify that sale proceeds are received for all items sold. The controller explored the need for additional space for secured storage of the safe deposit contents to reduce the overcrowding.

The controller completed its Request for Proposal with a private auctioneer to conduct a large public auction of unclaimed property. Additionally, the controller created new procedures to verify and reconcile public auction proceeds to the actual hammer price from the auction. The controller developed a plan to implement programming changes to post auction proceeds to the related owner's account.

**Finding #9: The controller does not ensure the collection of all unclaimed property.**

The controller's Financial-related Audits Bureau (audit bureau) does not always fully pursue unclaimed property that its auditors have a reasonable basis for believing should be remitted to the State. Specifically, we found that even though its auditors estimated in January 2002 that one holder failed to remit \$6.7 million beginning as far back as 1978, the audit bureau did not move forward to substantiate or invalidate the estimated findings. After we brought this to the controller's attention, the audit bureau reopened the examination of the holder. Assuming that the audit bureau substantiates the \$6.7 million and the holder remits the funds on June 30, 2003, the estimated interest penalty would be nearly \$8.2 million, resulting in the potential collection of more than \$14.9 million. By not exercising due diligence in pursuing the collection of unclaimed property that there is a reasonable basis to believe should have been remitted,

the controller is not fulfilling its responsibility to reunite owners with their lost or forgotten property.

To ensure that it collects all unclaimed property, the controller should complete its examination of estimated unclaimed property that its auditors have a reasonable basis for believing should be remitted to the State. Further, the bureau should ensure that it bills and collects the applicable interest penalties based upon the results of the audit bureau's examination.

***Controller's Action: Pending.***

The controller plans to complete its follow-up examination to substantiate or invalidate the estimated unclaimed property referred to in the examination of this holder by January 31, 2004. Further, the controller plans to bill the holder for any additional audit findings by February 27, 2004.



# GOVERNOR'S OFFICE OF EMERGENCY SERVICES

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## ***Its Oversight of the State's Emergency Plans and Procedures Needs Improvement While Its Future Ability to Respond to Emergencies May Be Hampered by Aging Equipment and Funding Concerns***

REPORT NUMBER 2002-113, JULY 2003

Governor's Office of Emergency Services' response as of September 2003

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### ***Audit Highlights . . .***

*Our review of the Governor's Office of Emergency Services' (OES) and counties' ability to coordinate and respond to multijurisdictional and multiagency emergencies revealed the following:*

- OES lacks a formal process to regularly review and update the State Emergency Plan and its related annexes.*
  - OES does not consistently perform activities needed to evaluate and improve its coordination of emergency responses under the Standardized Emergency Management System.*
  - Clarification of the roles and responsibilities of the State's Office of Homeland Security and OES would be beneficial.*
  - With aging equipment and other equipment not in place, OES's ability to task its own resources during an emergency may be limited.*
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The Joint Legislative Audit Committee (committee) requested that the Bureau of State Audits (bureau) review and assess the Governor's Office of Emergency Services' (OES) policies and procedures for assessing and coordinating multijurisdictional and multiagency responses to emergencies under the Standardized Emergency Management System (SEMS) and the emergency plan. Further, the committee requested the bureau to determine if OES is maintaining the emergency plan as required by law and whether a sample of local government emergency operation centers (EOCs) are adequately prepared to respond to emergencies following SEMS. We found that the State's emergency plan and related annexes provide adequate guidance to agencies responding to multijurisdictional emergencies, but that OES lacks a formal process to regularly evaluate and update these plans. Additionally, OES is not consistently evaluating the use of SEMS by preparing statutorily required after-action reports following all declared disasters. Also, OES has had difficulty in acquiring and maintaining emergency response equipment due to what it asserts is inadequate funding. Finally, our review of six county EOCs found that they had adequate plans and training to prepare for emergencies. However, OES's recent survey of all county EOCs reveals that some counties are in need of potentially costly upgrades to improve their ability to respond to emergencies.

**Finding #1: OES has not established a formal process to regularly evaluate and update the state emergency plan and related annexes.**

Although we found that the State's emergency plan and related annexes adequately guide agencies to respond to emergencies, OES lacks a formal process to regularly evaluate and update these documents as necessary. OES indicates that previous emergency plan updates were made in 1959, 1984, 1989, 1998, and 2003. OES's review of the plan in 2003 was part of a federal effort to ensure that the emergency plan is current. When we asked whether OES regularly updates the emergency plan and related annexes, the director of OES's Planning and Technological Assistance Branch explained that they do not, but that they are updated when changes in state or federal laws impact emergency management, or when changes in regulations, policies, or significant procedures occur. Although OES has not established a formal process to regularly review the emergency plan and its related annexes, other states regularly update their plans so that they may incorporate lessons learned into their plans. Absent a formal and regular evaluation process for the emergency plan and its related annexes, the State's emergency plan and annexes may not reflect current practices or provide sufficient guidance during an emergency.

To ensure that the emergency plan and its related annexes are regularly evaluated and updated when necessary, we recommended that OES develop and follow formal procedures for conducting regular assessments of these plans to determine if updates are required.

***OES Action: Partial corrective action taken.***

OES indicates it is in the process of revising the plans review policy in the OES Policy and Procedures Manual to incorporate review and maintenance of the State's emergency plan. The revised policy will establish a formal time frame for review and progressive maintenance of the State's emergency plan based upon a review checklist, which is under development. The checklist includes planning criteria from multiple state and federal publications that focus on preparedness and response planning considerations.

**Finding #2: OES has not consistently evaluated the use of the SEMS.**

OES is missing important opportunities to identify and make improvements to SEMS. This is because OES fails to consistently and adequately prepare, or follow up on, the statutorily required

after-action reports following declared disasters to incorporate lessons learned during proclaimed emergencies. OES also does not follow its own policies of maintaining SEMS through regular meetings of its SEMS advisory board and technical group—two user groups that are intended to review SEMS issues and make recommendations for improvement. Since SEMS establishes the organizational framework through which multiple agencies can jointly respond to an emergency, it seems reasonable to expect OES to take a more proactive role in ensuring that this critical element of California’s emergency response effort is consistently evaluated for further improvements and enhancements.

To ensure that SEMS remains a workable method to respond to emergencies, OES should more consistently evaluate its use and identify areas of weaknesses and needed improvements. Specifically, OES should do the following:

- Institute internal controls to ensure it receives after-action reports from all responding entities to an emergency, such as requiring after-action reports prior to reimbursing local agencies for response-related personnel costs. Further, OES should ensure that the reports by local governments evaluate the use of SEMS for any needed improvements and enhancements.
- Prepare after-action reports after each declared disaster that review emergency response and recovery activities.
- Develop a system that tracks weaknesses noted in the after-action reports, which unit is responsible for correcting those weaknesses, and what corrective actions were taken for each weakness.
- Reconvene the SEMS advisory board and technical group to foster more communication on the use of SEMS, and to provide OES advice and recommendations on SEMS.

***OES Action: Partial corrective action taken.***

OES is developing policies and procedures for development of after-action reports to consistently evaluate SEMS. The policies and procedures will address automatic assignment of responsibilities for the after-action reports, required and optional content, process for evaluating SEMS compliance, recommendations for follow-up and change, and a clear indication of those declared disasters that do not require an after-action report.

OES indicates that SEMS issues are addressed at ongoing statewide forums, such as the Statewide Emergency Planning Committee, the OES Fire and Rescue Advisory Committee/ FIREScope Board of Directors, and other related meetings. Additionally, OES continues to convene the Mutual Aid Regional Advisory Committees in all six mutual aid regions where SEMS-related issues are identified and discussed. Any significant issue will be raised to OES's management for evaluation and appropriate action, including convening the SEMS advisory board and/or the technical group.

**Finding #3: Data problems prevent OES from evaluating how well it coordinates resources during emergencies.**

Inaccurate and missing data in its Response Information Management System (RIMS) prevents OES from evaluating how well it coordinates responses during emergencies. Because OES is not using RIMS to capture accurate mission approval times and resource arrival times, it lacks data to evaluate how well it coordinates emergency responses. Mission approval times are important because the faster OES approves a resource request, the faster resources are likely to arrive on scene. Our review of RIMS data revealed that 13 out of 27 sampled mission approvals were late, and we were unable to determine the resource approval time for two of the requests. Furthermore, our testing showed that RIMS users did not report resource arrival times for 24 out of 27 resource requests in our sample. If OES had this information, it could evaluate whether resources are arriving promptly to emergency sites while better tracking the resources tasked to emergencies.

We recommended that OES take steps to ensure that it can accurately track how long it takes to approve resource requests and pinpoint when those resources arrived at the emergency.

***OES Action: Pending.***

OES indicates it will convene a meeting of an internal RIMS Working Group to address these findings and assess how to incorporate our recommendations. The first meeting will be held on October 20, 2003, where the group will begin to evaluate possible RIMS upgrades, discuss SEMS forms and reports improvements, and propose mission tasking application modifications. The group will also discuss system

changes to ensure that RIMS data is accurate and consistent. Following discussions with OES in November, we learned that the October 20<sup>th</sup> meeting took place.

The group will also determine how best to utilize RIMS for the Fire and Rescue Branch and explore all available options to meet its needs. Future plans include expanding the group to local government representatives for their input, as well as surveying RIMS users for system improvement ideas.

**Finding #4: OES needs to ensure key staff are properly trained.**

Citing a lack of funding, OES has not conducted a needs assessment to determine the training needs for management and workers that staff state and regional centers. OES has developed an individual training plan (training plan) program; however, OES had only developed training plans for seven of the 14 state center staff we reviewed. Although the training plan can be a useful tool, because OES does not use it for all state center staff and does not provide guidance to all supervisors preparing training plans, OES cannot ensure that all state center staff receive the training they need to effectively respond to emergencies.

To ensure that state agencies—including itself—are adequately prepared to respond to emergencies within the State, OES should determine the most critical training that emergency operations center staff, at state and regional levels, need in order to fulfill their duties, and then allocate existing funding or seek the additional funding it needs to deliver the training.

***OES Action: Partial corrective action taken.***

OES indicates that its training policy was revised in June 2003. The policy, in part, outlines “core competencies” for all OES staff, which include principles of emergency management, SEMS (introduction and EOC functions), and RIMS. The training policy has been provided to all branch managers who have been asked to use it in the development of their staff’s individual training plans.

**Finding #5: Clarification of the roles and responsibilities of OHS and OES would be beneficial.**

In February 2003, the governor established the Office of Homeland Security (OHS) within the Office of the Governor. Some of the responsibilities assigned to OHS by the executive

order and to the director of OES appear to have the potential to overlap. For example, under the California Emergency Services Act, the director of OES is assigned the responsibility of coordinating the emergency activities of all state agencies during a state of war emergency or other state emergency, and every state agency and officer is required to cooperate with the director in rendering assistance. However, under the executive order, OHS is assigned the responsibility of coordinating security efforts of all departments and agencies of the State and the activities of all state agencies pertaining to terrorism-related issues, and is designated as the principal point of contact for the governor. Moreover, the director of OES is required to report to the governor through OHS, but that reporting function is not limited to issues related to state security or terrorism, and thus appears to require OES to make all reports to the governor through OHS.

To ensure the State is adequately prepared to address emergencies and to avoid misunderstandings, OHS should work with the governor on how best to clarify the roles and responsibilities of OHS and OES.

***OES Action: Partial corrective action taken.***

OHS indicates that it continues to work with OES and the Governor's Office to clarify the roles and responsibilities, but offers no specific information about its efforts.

**Finding #6: Equipment concerns may impact OES's future ability to respond to emergencies.**

OES has had difficulty acquiring and maintaining emergency response and communication equipment due to what it asserts is inadequate funding. Specifically, 26 percent of OES's active fire engines have been in service for longer than the 17-year useful life that OES has adopted. OES also has no heavy urban search and rescue vehicles, which help extricate people from collapsed structures, despite a statutory mandate to obtain these vehicles. With aging equipment, and other equipment not in place, OES's ability to task its own resources during an emergency may be limited. OES has recently acquired sufficient funding to replace its aging fire engines and has taken steps to replace older fire engines, but its request for 18 heavy urban search and rescue vehicles was not funded. However, OES has not performed a current needs assessment to determine how many heavy urban search and rescue vehicles it needs in order to respond to an emergency within one hour, as required under statute.

Further, OES has not tried to establish the thermal imaging equipment-purchasing program required by law. OES's failure to take the statutorily required steps to establish this program may have denied local governments from taking advantage of an opportunity to obtain this equipment at a lower cost than they could obtain on their own. Finally, OES is facing a problem with its Operational Area Satellite Information System (OASIS), a satellite network that serves as a backup communications system, which is degrading and threatens OES's ability to coordinate with local governments should phone communications become disabled during a major emergency.

To ensure that it and local governments have the equipment to adequately respond to emergencies, OES should take the following actions:

- For its fire engine program, OES should continue with its schedule for replacing older and poor performing fire engines in the fleet.
- OES should perform a needs analysis to determine the number of heavy urban search and rescue units that are required to respond to a major earthquake. If this needs analysis concludes that additional units are required, OES should submit a budget change proposal to acquire this equipment, and it should develop a maintenance and replacement schedule for this equipment.
- OES should take the required steps to establish a thermal imaging equipment-purchasing program, including determining the interest among local governments in purchasing this equipment. However, if OES determines that it cannot identify funding sources to pay its share, OES should explore the use of the State's buying power to enter into a contract that allows local governments to purchase this equipment at a lower cost.

OES should study options to extend the life of or replace OASIS. However, if it concludes that OASIS should be replaced, OES should justify this replacement by demonstrating that maintenance costs are exorbitant and that OASIS is down for excessive periods for repair.

***OES Action: Partial corrective action taken.***

OES states that it has taken the following actions regarding the recommendations above:

- OES indicates that it is taking possession of 21 new engines in accordance with the three-year procurement contract that was initiated in fiscal year 2000–01. Further, OES plans to obtain an additional 21 engines over the next three years. According to OES, all of its fire engines continue to undergo annual safety inspections, as well as after each fire incident.
- OES indicates that it will update its initial needs analysis for heavy rescue units in the State by conducting a current assessment of the statewide capability. However, OES states that it is restricted from submitting budget change proposals for more heavy rescue units, but will explore funding through other sources.
- OES plans to convene a committee meeting in January 2004 to discuss the legislative mandate for thermal imaging equipment. OES will identify further corrective action following this committee meeting.
- OES indicates that it has now executed a new three-year maintenance contract for its OASIS system. The contract period covers January 2003 through December 2005. OES states that it will continue to seek options for upgrading and extending the life of OASIS through the federal grant process, partnering efforts with other state and local agencies, and the State’s budget change proposal process.

# TERRORISM READINESS

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## ***The Office of Homeland Security, Governor's Office of Emergency Services, and California National Guard Need to Improve Their Readiness to Address Terrorism***

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### ***Audit Highlights . . .***

*Our review of the Governor's Office of Emergency Services' (OES) and the California National Guard's (National Guard) terrorism readiness activities revealed:*

- Both agencies have developed plans that adequately guide their response to terrorist events, but OES has not included a prevention element in the State's terrorism response plan.*
- OES has not always identified the critical training that staff in the operations centers need to effectively complete their duties.*
- OES does not regularly develop and administer state-level terrorism readiness exercises with other state and local agencies, as its terrorism response plan requires.*
- Clarification of the roles and responsibilities of the State's Office of Homeland Security and OES would be beneficial.*

*continued on next page*

**REPORT NUMBER 2002-117, JULY 2003**

**Office of Homeland Security, Governor's Office of Emergency Services, and California National Guard responses as of September 2003**

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct an audit of the terrorism readiness efforts of the Governor's Office of Emergency Services (OES) and the California National Guard (National Guard). Specifically, the audit committee asked that we review and evaluate the terrorism prevention and response plans, policies, and procedures of these agencies and determine whether the plans are periodically updated and contain sufficient guidance. It also asked that we determine whether OES and the National Guard have provided sufficient training to their staff to effectively respond to terrorism activities and assess how the training compares to best practices or other reasonable approaches. The audit committee further requested that we determine whether both agencies take advantage of all state and federal funding for terrorism readiness. Finally, the audit committee asked that we determine whether the National Guard's recruitment and retention practices and staffing levels impact its readiness to respond to terrorism activities or its ability to attract qualified personnel for terrorism readiness positions.

### **Finding #1: The terrorism response plan guides the State's response but does not include ways to help prevent terrorism.**

Although the State Emergency Plan (emergency plan) and terrorism response plan adequately define the roles and responsibilities of numerous state and local agencies in responding to various emergencies, including terrorism, they do not address how the State could help prevent terrorist attacks from occurring. Lacking in the terrorism response plan is guidance for terrorism prevention. One reason for this deficiency may be that

- ☑ *Although the National Guard generally relies on its members' military training to respond to terrorism missions, it has not provided all of the training its staff in its Joint Operations Center needs to adequately respond to these missions.*
  - ☑ *The National Guard believes it has not had sufficient funding to participate in exercises involving other state and local emergency response agencies.*
- 

the Legislature did not envision a prevention role when it established OES in the California Emergency Services Act (act). Rather, the act sets the focus of OES as coordinating the State's response activities. However, the State needs to plan how it can help prevent terrorist events from occurring to best protect the citizens of the State against the consequences of such events. Acknowledging this void in the current terrorism response plan, the director of the Office of Homeland Security (OHS) stated that his office plans to revise the current state plan to make it more concise and include a prevention component.

To ensure that the State is adequately prepared to address terrorist threats, OHS should continue its plans to develop a state plan on terrorism that includes a prevention element

***OHS Action: Corrective action taken.***

OHS states that it is identifying key prevention elements that should be incorporated into the terrorism response plan.

**Finding #2: OES has no formal process to periodically review and update the terrorism response plan.**

OES lacks a formal process to regularly review the terrorism response plan and update it as determined necessary. Rather, OES staff state that they update the terrorism response plan when changes in statute affecting emergency management or changes occur in regulations, policies, or significant procedures. Although OES has not established a formal process to regularly review the terrorism response plan, other organizations and states we contacted do regularly update and incorporate lessons learned into their plans. Without an established process to regularly review the plan, OES cannot ensure that it remains current and adequately protects the State. Furthermore, OES would make its assessment more consistent and effective if it developed a checklist to guide its efforts in evaluating the terrorism response plan.

OHS and OES should ensure that the state plan addressing terrorism is reviewed on a regular basis and updated as determined necessary to ensure that it adequately addresses current threats and benefits from the lessons learned in actual terrorist readiness events occurring both in California and nationwide. Additionally, they should develop a checklist to guide periodic evaluations of the state plan addressing terrorism to ensure that such assessments are consistent and effective.

***OES Action: Corrective action taken.***

OES states that it is developing formal procedures to review, assess, and update the emergency plan and its related annexes, including the terrorism response plan. OES also states that it is developing a checklist to guide its reviews.

**Finding #3: OES has not identified the training needs for all of its staff.**

OES has not conducted a needs assessment to determine the training requirements for all personnel in its state and regional operations centers. Although OES does develop individual training plans for some of its staff, which identify an individual employee's career goals and objectives, it does not prepare them for all staff working in state and regional operations centers. Furthermore, OES does not provide guidance to all supervisors preparing the training plans to ensure that they include training related to core competencies. Core competencies are the key skills employees need to possess to perform their assigned duties.

To ensure that state agencies, including OES, are adequately prepared to respond to terrorist events occurring within the State, OES should identify the most critical training required by staff at state and regional operational centers and then allocate existing funding or seek additional funding it needs to deliver the training.

***OES Action: Corrective action taken.***

OES states that it has identified the core competencies for all OES staff and has developed a training policy to guide managers as they develop training plans for OES staff.

**Finding #4: OES has not conducted state-level terrorism readiness exercises as called for in its terrorism response plan.**

With the exception of federally or state mandated exercises associated with nuclear power plants and hospitals, the State does not presently have an established program to provide exercises to ensure that state agencies are prepared to respond to terrorist events. According to OES, it has not regularly developed and administered terrorism readiness exercises because it is not funded to do so. However, it has not requested state funding to conduct the exercises. OES has participated in terrorism readiness exercises when other agencies have held them, and staff have received training through activation experiences.

However, these activities would not necessarily test and enhance the capabilities of state agencies, local governments, and related entities to prepare for, respond to, and recover from terrorist events as called for in the terrorism response plan. OHS has recently decided that the California National Guard should be responsible for coordinating state-level exercises, awarding \$1.6 million in federal funds to them. Because of the unique role that OES plays in coordinating emergencies, it will be important for OES to work with the National Guard to establish an effective exercise program.

To ensure that state agencies, including OES, are adequately prepared to respond to terrorist events occurring within the State, OES should assist the National Guard in providing state-level terrorism readiness exercises.

***OES Action: Corrective action taken.***

OES states that it is developing a functional exercise for the state and regional operations centers. It also states that it will continue to work with the National Guard in developing terrorism readiness exercises.

**Finding #5: The effect of budget cuts are uncertain.**

An OES analysis stated that budget cuts it is required to sustain due to the current state budget crisis will severely hinder its ability to fulfill its overall mission, including terrorism readiness. However, since February 2003, OES is to report to the Governor's Office through the OHS director, and the OHS director told us he believes that OES can meet its statutory mission despite budget cuts incurred as of June 2003. To optimize its efficiency, the OHS director intends to assess the OES organization to identify more efficient ways for OES to fulfill its statutory responsibilities, focusing its resources on mission-related activities.

To ensure that the State is adequately prepared to address terrorist threats, OHS should continue its plans to thoroughly assess OES functions to determine how it can optimize its efficiency.

***OHS Action: Pending.***

OHS states that it continues to assess OES functions to evaluate how best to address the budget cuts and that once the 2004–05 budget is finalized, it will be better able to address this finding.

**Finding #6: Clarification of the roles and responsibilities of OHS and OES would be beneficial.**

The authority provided to OES under the act and the authority provided to OHS by the governor's February 2003 executive order appear to have the potential to overlap. Further, the directors of the two offices appear to have differing views on their roles and responsibilities. A lack of clarity in their respective roles and responsibilities could adversely affect the State's ability to respond to emergencies, such as a terrorist event.

To ensure that the State is adequately prepared to address terrorist threats, OHS should work with the governor on how best to clarify the roles and responsibilities of OHS and OES.

***OHS Action: Pending.***

OHS states that it is working with OES and the Governor's Office to clarify the roles and responsibilities of the two offices.

**Finding #7: Joint Operations Center staff have not yet completed all the training they need to effectively coordinate missions.**

The Joint Operations Center is responsible for receiving state missions from OES and developing and overseeing the National Guard's response to requests for its services. In June 2002, the Joint Operations Center identified training it believes its staff need to adequately respond to state emergencies. However, 32 of the 38 members required to take specific courses had received less than half the designated training. According to the National Guard, lack of funding and limited availability of classes have hindered its ability to train its Joint Operations Center staff in the identified areas. Without proper training, the ability of the National Guard to respond promptly and effectively to state missions may deteriorate.

To ensure that its members are adequately trained to respond to terrorism missions, the National Guard should determine the most critical training its Joint Operations Center staff need to fulfill their duties and then allocate existing funding or seek the needed funding to provide the training, documenting why it is needed.

***National Guard Action: Corrective action taken.***

The National Guard states that it has developed a plan that identifies the training needed by the various members of the Joint Operations Center. The National Guard adds that it has not received any additional funding to provide training to members of the Joint Operations Center.

**Finding #8: The Army Guard Division does not provide required terrorism awareness training to its members.**

The National Guard's Army Guard Division does not provide terrorism awareness training required by U.S. Army regulations as part of its terrorism readiness force protection (force protection) program. According to the commanders of the Army Guard units we visited, the reason they have not fully implemented the terrorism awareness training is that they have not received the guidance to implement it. Further, although the regulation provides that one way the units can offer the required training is through an approved web-based course, the director of the Joint Operations Center stated that his office had been unaware of such a course until recently. However, while visiting an Air Guard unit in April 2003, we discovered that it had been using a Web-based course to fulfill the requirement for terrorism awareness training since June 2002. Therefore, despite its responsibility for implementing the force protection program in both the Air Guard and Army Guard divisions, the Joint Operations Center was unaware of the practices of the Air Guard Division that could have benefited the Army Guard Division. Had the Joint Operations Center been more aware of the training being utilized in the Air Guard Division, it could have identified this best practice and shared it with the Army Guard Division.

The National Guard should develop guidance for its Army Guard Division to implement its terrorism readiness force protection program. Additionally, it should ensure that its Joint Staff Division, including the Joint Operations Center, share best practices between its Air Guard and Army Guard divisions.

***National Guard Action: Partial corrective action taken.***

The National Guard states that the Army Guard Division is developing a regulation to implement its terrorism readiness force protection program, commenting that it should be fully implemented by December 2004. Additionally, the National Guard states that the Chiefs of Staff for the Army, Air, and Joint Staff divisions meet each week and include a discussion of best practices among the divisions.

**Finding #9: The National Guard would benefit from increased state-level terrorism exercises**

The National Guard believes that it has not had sufficient opportunities to participate in exercises with other state and local emergency response agencies. In June 2003, OHS advised us that it has now allocated \$1.6 million in federal funding to the National Guard to coordinate terrorism readiness exercises that include both state agencies and rural jurisdictions. Therefore, the National Guard should soon be able to participate in terrorism readiness exercises with other state and local emergency response agencies.

The National Guard should use the recently awarded funds from OHS to identify the type and frequency of state-level exercises responding to terrorist events that the State needs to be adequately prepared. The National Guard should then provide the exercises it has identified.

***National Guard Action: Partial corrective action taken.***

The National Guard states that it has formed an exercise management team consisting of staff from the National Guard and other state and local agencies that have first responder responsibilities. With current grant funding, the National Guard plans to coordinate four regional and one statewide exercise by October 2004.



# CALIFORNIA LAW ENFORCEMENT AND CORRECTIONAL AGENCIES

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## ***With Increased Efforts, They Could Improve the Accuracy and Completeness of Public Information on Sex Offenders***

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### **Audit Highlights . . .**

*Our review of the Department of Justice's (Justice) database of serious and high-risk sex offenders, known as the Megan's Law database, disclosed the following:*

- The Megan's Law database contains thousands of errors, inconsistencies, and out-of-date information.*
- Because it excludes records for some serious and high-risk sex offenders and erroneously lists others as incarcerated, the Megan's Law database does not inform the public about these offenders.*
- Conversely, because it includes hundreds of duplicate records and erroneously indicates that 1,142 incarcerated sex offenders are free, it may unnecessarily alarm the public.*
- The address information for roughly 23,000 records in the Megan's Law database has not been updated for at least a year largely because sex offenders have not registered.*

*continued on next page*

**REPORT NUMBER 2003-105, AUGUST 2003**

**Department of Justice's response as of December 2003**

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to evaluate the accuracy of the State's database of registered sex offenders. Further, the audit committee asked us to determine if state and local law enforcement agencies are implementing Megan's Law in a manner that maximizes the registration data's accuracy. Lastly, we were asked to identify deficiencies in the current state Megan's Law that hinder the accuracy of the sex offender data and to provide legislative recommendations to address identified deficiencies.

### **Finding #1: The Megan's Law database omits some records of juvenile sex offenders tried in adult courts, and inappropriately includes others.**

The law provides that only juveniles with juvenile court adjudications for their sex offenses are protected from public disclosure under Megan's Law. However, we found omitted from the Megan's Law public information a total of 51 Department of the Youth Authority (Youth Authority) records of juvenile sex offenders tried in adult courts. In 20 cases, Department of Justice (Justice) staff did not mark the records as coming from adult courts; in 31 other cases, Youth Authority or Department of Corrections (Corrections) did not prepare pre-registration or notification forms or Justice did not receive or process them. Without information about serious and high-risk juvenile sex offenders tried in adult courts and released into communities, California residents have no way of knowing that they are living near these convicted offenders.

In addition to problems with the overall accuracy of the Megan's Law database, we found that Justice does not always prevent the public disclosure of juvenile sex offenders' records. Specifically, Justice erroneously disclosed to the public 42 records for sex

☑ *Although Justice maintains that its primary responsibility is to compile the sex offender data it receives from law enforcement agencies and confinement facilities, it has taken steps to improve the accuracy of the information in the Megan's Law database.*

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offenders convicted in juvenile courts, thwarting the additional protection and confidentiality that the Legislature has afforded to juveniles.

To ensure that the records of juvenile sex offenders are properly classified and disclosed to the public, we recommended that Justice do the following:

- Coordinate with the Youth Authority and periodically reconcile its sex offender registry with Youth Authority information.
- Provide training to its staff regarding the proper classification of records, such as flagging juvenile records appropriately for public disclosure.
- Revise its pre-registration process with Youth Authority to include a request for court information, which can be used to properly classify juvenile records.
- Request the Judicial Council to amend its juvenile commitment form to require that Youth Authority send a copy of the form to Justice.

***Justice Action: Partial corrective action taken.***

Justice reports that it worked with Youth Authority to develop an automated process for updating juvenile sex offender status in the Violent Crime Information Network (VCIN) with Youth Authority data. Justice has implemented this process and plans to use it to update the VCIN monthly. It is working on other modifications that will improve data synchronization between Justice and Youth Authority, and plans to complete them by the end of January 2004. Justice also implemented new procedures and trained its staff to ensure that all juvenile sex offender records are properly classified for purposes of public disclosure. Additionally, the Judicial Council is evaluating legal issues associated with Justice's request for Youth Authority to provide more detailed court disposition information with sex offender registration documents to help facilitate the classification process.

**Finding #2: The Megan's Law database omits some records with inaccurate offense codes.**

Of approximately 18,000 records in the VCIN that are classified as "other" and not shown to the public, Justice identified 1,900 records that have offense code 290 rather than the more specific

offense codes for which the sex offenders were convicted. Local law enforcement agencies and Justice staff sometimes enter the 290 offense code in reference to the section of the California Penal Code that mandates registration for sex offenders when they are uncertain of the appropriate code, and the VCIN automatically classifies records with this offense code as “other.” Records classified as other are not included in the Megan’s Law database and thus not disclosed to the public. Justice ultimately determines the proper offense code by researching conviction information, but stated that until recently it has not had the necessary staffing resources to do the work. Justice subsequently updated the offense code for 497 of the 1,900, raising the classification to serious for 351 of them. For most of the remaining 1,403 records, Justice is waiting for responses from other states.

We recommended that Justice continue reviewing records for which it has only the 290 offense code and update the offense codes as appropriate.

***Justice Action: Corrective action taken.***

Justice continues to review criminal history information to verify that registered sex offenders are properly classified for purpose of public disclosure in the Megan’s Law database. As of December 9, 2003, Justice has reviewed approximately 15,500 of the approximate 18,000 sex offenders classified as “other,” resulting in the reclassification of 1,390 of these sex offenders to “serious.” Justice is in the process of researching the remaining 2,500 records, most of which have offense code 290, and has requested conviction information from courts.

**Finding #3: Some sex offender records continue to indicate the incarcerated status after offenders are discharged from prison or paroled, while others show incarcerated sex offenders as residing in local neighborhoods.**

We found that for 582 records in VCIN that indicate the offenders are in prison, there were no records with matching Criminal Information and Identification (CII) numbers on Corrections’ list of inmates. A sample of 59 of these revealed that 48 of the offenders were no longer in prison. Another 1,142 records incorrectly indicate the sex offenders are free when, in fact, they are incarcerated. Additionally, of 2,575 records Justice identified as pending release from prison for more than a year, 1,787 of these offenders had already been released. Because Justice does not review Corrections’ monthly list of prison inmates to identify sex offenders who

appear on the list one month but not the next, it does not know if Corrections should have completed a form notifying Justice and local law enforcement that it will soon be releasing a sex offender or that one has died, and Justice does not know which offenders require follow-up to determine their true status. Unless Justice corrects these records or these offenders register, their records in the Megan's Law database will continue to incorrectly indicate that they are incarcerated.

We recommended that Justice regularly compare its records showing the incarcerated status with information provided by Corrections to determine which sex offenders are confined and those who are no longer in confinement, continue to work with Corrections to improve this process, and produce exception reports to resolve those records in question. Justice can then update these records appropriately.

***Justice Action: Pending.***

Justice is in the process of modifying the program it uses to update the VCIN using Corrections' list of incarcerated sex offenders, so that an offender's incarceration status will be removed from the Megan's Law database when it no longer appears on Corrections' list. The offender's status will automatically change to "released" and a violation notice will be activated if the offender does not register with local law enforcement as required. Justice is also modifying the VCIN to generate violation notices based on the date of release, rather than on the date of notification, as reported in the pre-release notification documents. Justice anticipates it will complete these changes by the end of January 2004. According to Justice, these changes will significantly reduce future discrepancies between Justice's and Corrections' data.

To the extent possible, Justice and Corrections will pursue other methods for ensuring complete synchronization of sex offender data. However, Justice believes that it would not be practical to generate monthly exception reports as a means of identifying any sex offender records that cannot be properly matched to Corrections' data. It says that the use of such reports would be extremely time-consuming, since it would potentially require the manual research of thousands of possible matches each month.

**Finding #4: The Megan’s Law database includes hundreds of duplicate records primarily created by personnel who lack adequate training.**

We identified 437 records in the Megan’s Law database that were obvious duplicates of other database records. Consequently, the public cannot rely on the sex offender information shown in a zip code search to identify the number of offenders in a specific community. The public also cannot rely on the information retrieved from the Megan’s Law database in response to a search for a specific sex offender by name, because more than one record can appear for an offender and, without dates on the records, the public cannot determine which record is the most current.

Personnel who update sex offender records create duplicate records because they do not always search for existing records before creating new ones. According to Justice’s policies and procedures, when a sex offender registers, personnel updating sex offender records are required to search the database to determine if the offender matches existing records. However, Justice has not provided sufficient training to its personnel and to all local law enforcement agencies that update sex offender records. For example, we found that personnel at one city’s police department entered 89 of the 437 duplicate records.

We recommended that Justice periodically analyze its data to identify and eliminate obvious duplicates. As a first step, Justice should review the bureau’s analysis identifying obvious duplicate records and eliminate these duplicate records. Additionally, to ensure that local law enforcement and its own staff update sex offender information appropriately, we recommended that Justice design and implement an appropriate training program.

***Justice Action: Partial corrective action taken.***

Justice has implemented an improved system for identifying duplicate records in the VCIN through a specially designed data-string search and manual verification process. As a result of the initial search conducted in August 2003, Justice identified and eliminated 512 duplicate records from the database. In late October 2003, Justice began these searches on a weekly basis and as of December 9, 2003, identified 273 additional duplicate records, which it has merged and deleted. These weekly searches will augment the existing process of identifying duplicate records based on a cross match of CII numbers.

In addition, by mid-2004 Justice plans to complete the programming necessary to implement Live Scan, an electronic fingerprinting technology, allowing local law enforcement agencies to electronically transmit to Justice the offenders' fingerprints with each registration transaction. The fingerprints will be automatically verified for immediate and reliable identity confirmation, which according to Justice, will eliminate duplicate entries.

Also, Justice has been working with local law enforcement agencies to research and identify options for providing a statewide training program designed to improve the accuracy of sex offender data from both data entry and field enforcement standpoints. To determine how best to deploy its limited training staff, Justice has been soliciting local agency input regarding their need for training and other assistance through field contact, surveys, and a regional law enforcement meeting. Based on this input, Justice will modify its existing technical training program to focus on problem areas, incorporate enforcement strategies in the curriculum, and achieve greater efficiency through regional training it facilitates. Justice has trained its staff who process registration information in order to minimize technical errors that may contribute to data inaccuracy and plans to conduct this internal training on an ongoing basis.

**Finding #5: The Megan's Law database does not show when sex offenders' records were updated, limiting the information's usefulness to the public.**

Because the Megan's Law database does not include the dates of offenders' registrations, the public has no way of distinguishing the records recently updated from those updated long ago, thereby limiting the usefulness of the information. We found that approximately 23,000 records were last updated before April 2002, and about 14,000 of those were last updated before April 1998. Often, registrants do not comply with annual registration requirements, and many offenders with outdated information are not required to register in California because they may have moved outside the State, been deported or incarcerated, or are deceased. Without information in the Megan's Law database to tell them whether the last update was a week or five years ago, or a specific disclaimer explaining the possibility of outdated data, people viewing the database cannot evaluate the usefulness of the information they read.

We recommended that Justice modify the Megan’s Law database to include the date that the registration information was last provided.

***Justice Action: Corrective action taken.***

Justice has modified the Megan’s Law database to include a message indicating if and for how long an offender has been in violation of registration requirements. According to Justice, the message reads: “Note: This sex offender has been in violation of registration requirements since <date>.” Justice states that vendors are developing foreign language translations of this message and anticipates adding them to the Megan’s Law database by February 2004.

**Finding #6: The public would be well served by Justice attaching disclaimers to the Megan’s Law database.**

Even if state and local agencies accurately reported all the information they receive, the Megan’s Law database would continue to be incomplete and inaccurate as a result of sex offenders not registering as required or providing inaccurate information when they do register. Currently, Justice includes some disclaimers in the information it provides the public. However, we believe that modifying the existing disclaimers and adding others about potential inaccuracies and errors could help the public better understand and use the data to protect themselves and their families. As of the end of our audit, Justice was in the process of finalizing additional disclaimers that incorporate our suggestions.

We recommended that Justice finalize its disclaimer information and direct law enforcement agencies to provide the disclaimers to the public members who view the Megan’s Law database. The disclaimer information should include the following:

- A statement that Justice compiles but does not independently confirm the accuracy of the information it gathers from several sources, including sex offenders who register at law enforcement agencies and custodians who report to Justice when sex offenders are released from confinement facilities. This statement should advise the viewer that the information can change quickly and that it would not be feasible for California’s law enforcement agencies to verify the whereabouts of every sex offender at any given time.

- A statement that the information is intended not to indicate the offenders' risk to the public but to help people form their own assessments of risk.
- A statement that the location information is based on the "last reported location," which may have changed.
- A statement to remind viewers that a fingerprint comparison is necessary to positively identify a sex offender.

***Justice Action: Corrective action taken.***

Justice developed a comprehensive disclaimer containing the specific elements we recommended and has added the English version of this disclaimer to the Megan's Law database. Justice anticipates that translations of the disclaimer in 12 other languages will be added to the Megan's Law database by mid-January 2004.

**Finding #7: Justice's review of the Megan's Law data has not been adequate.**

State law declares the Legislature's intent that Justice continuously reviews the sex offender information in the Megan's Law database. However, Justice has interpreted this intent language to direct it only to continually review the accuracy of its entry of information, not of the information itself. Our legal counsel agrees with Justice that the intent language is not binding and states that because Justice is responsible for administering the Megan's Law database, it has flexibility in determining how it will fulfill the Legislature's intent that it continually review sex offender data. However, we believe Justice's review has not been adequate because the Megan's Law database is intended for the public's use in safeguarding itself from dangerous sex offenders. According to Justice, because it is only a repository, not the originating source, of much of the Megan's Law information, it is beyond the purview of Justice to ensure that information provided by courts and registering agencies is accurate.

The Associated Press reported in January 2003, based on information provided by Justice, that Justice did not know the whereabouts of 33,296 registered sex offenders because they had not registered annually as required. Subsequently, Justice determined that 663 of the 33,296 sex offenders had, in fact, registered within the past year. In addition, Justice confirmed that 2,833 sex offenders are living outside the State and

1,360 are deceased. However, Justice received either outdated, incomplete, or no information on the remaining 28,440 sex offenders who did not register.

Justice obtained information on deaths from the Department of Health Services (Health Services), deportations from the Immigration and Naturalization Service (INS), and sex offenders living in other states from the National Law Enforcement Telecommunication Services. However, until 2003, Justice had not requested death information to use for updating sex offenders' records. According to Justice, previously it did not obtain the information from Health Services or the INS because it has no underlying statutory responsibility for seeking out information from these agencies.

We recommended that Justice design and implement a program to check the data as a whole for inconsistencies and periodically reconcile the data with other reliable information. Additionally, we recommended that Justice continue to work with Health Services, the INS, and other public agencies to obtain valuable information and update the sex offenders' records.

***Justice Action: Corrective action taken.***

Justice has contracted with Health Services and the Social Security Administration to regularly obtain updated death certificate information. It will use this information on a quarterly basis to update sex offender information in the VCIN. Also, Justice recently compared records in the VCIN with deportation records maintained by the INS and updated the VCIN to reflect offenders identified as deported. In November 2003, Justice obtained on-line access to INS' deportation files, which will enable it to identify on an ongoing basis sex offenders who have been deported. In addition, Justice has begun ongoing analysis of its sex offender database to identify and correct record errors, which includes a series of special searches for key words and unique transaction sequences that may indicate possible data entry errors.



# UNIVERSITY OF CALIFORNIA, SAN FRANCISCO

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## ***Investigations of Improper Activities by State Employees, February 2003 Through June 2003***

**ALLEGATION I2000-715 (REPORT I2003-2),  
SEPTEMBER 2003**

**University of California, San Francisco, response as of  
September 2003**

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### ***Investigative Highlight . . .***

***The University of California,  
San Francisco, used proprietary  
bidding specifications  
that restricted fair  
competition for a contract  
totaling \$495,000.***

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**A**fter investigating the allegation, we determined that the University of California, San Francisco (UCSF), used proprietary bidding specifications that restricted fair competition for several roofing projects under a contract totaling \$495,000 and thus may have violated state law and Regents' policies.<sup>1</sup> The specifications placed unnecessary requirements on potential bidders, which limited the number of contractors able to submit competitive bids for the projects. Further, the specifications unnecessarily forced contractors to use a specific manufacturer's products and limited their ability to use substitute products, even if the substitute products were less expensive and superior in quality. As part of our investigation, we hired a roofing consultant to evaluate the bidding specifications.

### **Finding: UCSF used specifications that restricted competitive bidding for roofing projects.**

In conflict with state law and Regents' policies, UCSF used specifications for roofing projects that restricted competitive bidding. According to our roofing consultant, the language used in UCSF's specifications primarily limited competition in three ways.

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<sup>1</sup> The Louisiana Office of State Purchasing defines a "proprietary specification" as a specification that cites brand name, model number, or some other designation that identifies a specific product to be offered exclusive of others. Stephen M. Phillips, who serves as counsel for the National Roofing Contractors Association and the National Roofing Legal Resource Center defines a "proprietary specification" (also known as a closed or restrictive specification) as any specification that is restrictive to a specific product.

First, the specifications included certain contractor requirements that served no purpose other than to limit the number of contractors competing for the work. For example, the specifications required contractors to list three projects in which they employed a similar type of roof system within a 50-mile radius of the project location. While requiring documentation of previous experience is valid, according to our consultant, specifying a 50-mile limitation served only to restrict competition.

Second, portions of the specifications forced potential bidders to use specific brand products produced by a single manufacturer. For example, the specifications' requirements differed from applicable industry standards in regard to two of the necessary products, so that only one brand of product could meet the specifications. The specifications also listed physical properties for the entire roof membrane. According to our roofing consultant, the only reason to impose such a requirement would be to limit contractors to using membrane products made by a single manufacturer.

Third, the specifications limited contractors' ability to use substitute products regardless of whether those substitutes were equal to or better than those products called for. In one instance, the specifications limited contractors' ability to submit alternative products, even if the substitute products were less expensive and had adequate or superior performance properties. In two instances, the specifications limited bidders' ability to fully assess the time and cost ramifications of providing substitute materials; in another instance, the specifications dictated that the contractor incur additional costs associated with submitting substitute products, costs, according to our consultant, the contractor should not bear. While using proprietary products and not allowing substitutions is appropriate in some instances, our consultant concluded in this instance it was not justified.

***UCSF Action: Partial corrective action taken.***



UCSF reported that the contract in question contained detailed requirements that it believes are based on legitimate business needs to ensure contractor availability at the construction site, maintain the product warranty, and discourage substitutions of potentially inferior roofing products. UCSF agreed that the specifications relating to the

manufacturer's products were tightly written, but added that it was done so as to minimize any impact on patients in the buildings affected. However, UCSF reported that the bid specifications for more recent contracts have been prepared with assistance from independent roofing consultants to avoid any appearance of inappropriate proprietary specifications that would unduly limit competition.



# SCHOOL BUS SAFETY II

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## **State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected**

REPORT NUMBER 2001-120, MARCH 2002

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### *Audit Highlights . . .*

*Our review of the School Bus Safety II mandate found that:*

- The costs for the mandate are substantially higher than what was initially expected.*
  - The costs claimed by seven school districts varied significantly depending upon the approach taken by their consultants.*
  - The different approaches appear to result from the lack of clarity in the guidelines adopted by the Commission on State Mandates (commission).*
  - Most of the school districts we reviewed lacked sufficient support for the amounts they claimed.*
  - The commission could have avoided delays totaling more than 14 months when determining whether a state mandate existed and in developing a cost estimate.*
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The Commission on State Mandates response, State Controller's Office response, and most school district responses as of March 2003<sup>1</sup>

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits examine the claims under the School Bus Safety II mandate. Specifically, we were asked to review the Commission on State Mandates' (commission) guidelines to determine if they adequately define the mandate's reimbursable activities and provide sufficient guidance for claiming reimbursable costs. In addition to examining any prior reviews of the claims, we were asked to examine a sample of claims to determine if the costs met the criteria for reimbursement. Finally, the audit committee asked us to evaluate the commission's methodology for estimating the future costs of this mandate.

### **Finding #1: The commission's guidance regarding claims reimbursement lacks clarity.**

The guidance issued by the commission does not provide sufficient clarity to ensure that school districts claim reimbursement for mandated activities in an accurate and consistent manner. Instead, the guidance established a broad standard that has allowed a variety of interpretations by school districts as to what costs to claim. The lack of clarity in the guidance appears to be the result of several factors, including the broad language in the statutes from which the guidelines were developed. In addition, the test claim process does not require the claimant to be specific when identifying activities to be reimbursed. Further, the commission's executive director states that the commission, as a quasi-judicial body, is limited in making changes to the guidelines. Finally,

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<sup>1</sup> School districts responding to the audit were Ceres Unified School District, Dinuba Unified School District, Elk Grove Unified School District (Elk Grove), Fresno Unified School District, and San Dieguito Union High School District. Elk Grove's response was as of October 2002.

the fact that the school districts' interests appear to have been better represented in the process than the State's also may have contributed to the ambiguity on this issue.

We recommended the Legislature amend the parameters and guidelines through legislation to more clearly define activities that are reimbursable and to ensure that those activities reflect what the Legislature intended. The guidelines should clearly delineate between activities that are required under prior law and those that are required under the mandate. To ensure that the State's interests are fully represented in the future, we recommended the commission ensure that all relevant state departments and legislative fiscal committees be provided with the opportunity to provide input on test claims and parameters and guidelines. Further, we recommended the commission follow up with entities that have indicated they would comment, but did not. Finally, we recommended that the commission notify all relevant parties, including legislative fiscal committees, of the decisions made at critical points in the process, such as the test claim statement of decision, the adoption of the parameters and guidelines, and the adoption of the statewide cost estimate.

***Legislative Action: Legislation passed.***

On September 30, 2002, the governor approved Assembly Bill 2781 (Chapter 1167, Statutes of 2002). This new law requires the commission to specify that costs associated with implementation of transportation plans are not reimbursable claims and requires the amended parameters and guidelines to be applied retroactively as well as prospectively.

***Commission Action: Corrective action taken.***

In January 2003, the commission amended the parameters and guidelines as outlined in Chapter 1167, Statutes of 2002. Additionally, commission staff implemented new procedures to increase the opportunity for state agencies and legislative staff to participate in the mandates process; notify relevant parties of proposed statements of decision, parameters and guidelines, and statewide cost estimates; and follow up with entities that are late in commenting on claims. For example, in addition to a letter initially inviting state agency participation, commission staff now send a letter notifying all parties of the tentative hearing dates for each test claim. Additionally, they send e-mail notices of release of analyses of test claims, proposed parameters and guidelines, statewide

cost estimates, and proposed statements of decision to fiscal and policy committee staff. Further, commission staff contact state agencies, claimants, and other relevant parties when comments are late.

**Finding #2: Most school districts we reviewed lacked sufficient documentation for their costs.**

We found that many school districts did not maintain sufficient documentation to support their claims. In fact, of the more than \$2.3 million total direct costs the seven districts we reviewed submitted for reimbursement in fiscal year 1999–2000, only \$606,000 (26 percent) was traceable to documents that sufficiently quantified the costs. To support the remaining \$1.7 million (74 percent), these school districts relied substantially upon incomplete supporting data. School districts are to follow the parameters and guidelines issued by the State Controller’s Office (Controller) when claiming reimbursement under the mandate. The districts asserted they had sufficient support, yet the documentation we reviewed lacked crucial elements, such as corroborating data, and failed to substantiate the amounts claimed for reimbursement in many instances. In addition, some school districts claimed amounts for time increases to complete school bus routes, yet they failed to maintain corroborating evidence to support these increases. Further, one district based much of the costs it claimed on questionable assumptions and even claimed for activities that appear to be beyond the scope of the mandate. Only San Diego City Unified School District had support for all the \$5,171 in direct costs it claimed. Additionally, San Jose Unified School District had sufficient documentation to support nearly all the \$590,000 in direct costs that it claimed.

School districts should ensure that they have sufficient support for the costs they have claimed. In addition, the commission should work with the Controller, other affected state agencies, and interested parties to make sure the language in the guidelines and the claiming instructions reflects the commission’s intentions as well as the Controller’s expectations regarding supporting documentation.

***School District Action: Partial corrective action taken.***

Ceres Unified School District, Dinuba Unified School District, and Fresno Unified School District conducted time studies to support costs associated with the mandate. San Dieguito Union High School District has taken steps to ensure that its claimed activities are supported by sufficient documentation, including ensuring that it properly maintains training records in its computer system. Elk Grove Unified School District previously stated that when the commission came out with new rules, regulations, and guidelines regarding the mandate, it would follow them.

***Commission Action: Corrective action taken.***

Commission staff worked with the Controller and others to amend existing parameters and guidelines and adopt new parameters and guidelines that reflected its intention and the Controller's expectations regarding supporting documentation. In January 2003, the commission adopted the Controller's proposed language, as modified by commission staff, that requires claimants to maintain documentation developed at or near the time actual costs were incurred in order to support their reimbursement claims. The commission intends to address the language in all future parameters and guidelines, and in existing parameters and guidelines as they are amended.

**Finding #3: The commission did not identify the true fiscal impact of the mandate until three years after the law was passed.**

The Legislature was not aware of the magnitude of the fiscal impact of its action when it passed the 1997 law that comprises the majority of the School Bus Safety II mandate. Three different entities that analyzed the 1997 law before its passage believed that it would not be a state mandate and thus the State would not have to reimburse the districts' costs. Further, these entities advised the Legislature that annual costs would be no more than \$1 million, considerably less than the \$67 million in annual costs that the commission is now estimating. This misperception of the likely costs prevailed until January 2001, when the commission finally released a statewide cost estimate. Although the commission is required to follow a deliberate and often time-consuming process when determining whether a test claim is a

state mandate and adopting a statewide cost estimate, it appears that it could have avoided a delay of more than 14 months. Consequently, the Legislature did not have the information necessary to act promptly to resolve the issues of possible concern previously discussed in this report. Finally, commission staff believe that waiting for actual reimbursement claims reported to the Controller and using this data to estimate statewide costs for the mandate results in more accurate estimates. However, commission staff have not sought changes to the regulations to include sufficient time for waiting for the claim data.

We recommended the commission ensure that it carries out its process for deciding test claims, approving parameters and guidelines, and developing the statewide cost estimate for mandates in as timely a manner as possible. If the commission believes it necessary to use actual claims data when developing the statewide cost estimate, it should consider seeking regulatory changes to the timeline to include the time necessary to obtain the data from the Controller.

***Commission Action: Corrective action taken.***

Commission staff implemented new procedures to ensure that it carries out its process in as timely a manner as possible. Specifically, they now propose statewide cost estimates for adoption approximately one month after they receive initial reimbursement claims data from the Controller. They also close the record of the claim and start their staff analysis if claimant responses are not submitted timely. Claimants who choose to rebut state agency positions at a later time may provide rebuttal comments to the draft staff analysis. Further, the commission initiated a rulemaking package in February 2003 to incorporate the current methodology for developing statewide cost estimates into the commission's regulations.



# LOS ANGELES UNIFIED SCHOOL DISTRICT

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## ***Outdated, Scarce Textbooks at Some Schools Appear to Have a Lesser Effect on Academic Performance Than Other Factors, but the District Should Improve Its Management of Textbook Purchasing and Inventory***

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### *Audit Highlights . . .*

*Our review of the Los Angeles Unified School District (LAUSD) concludes that:*

- Although we found more classes in low-performing schools that did not have enough textbooks for each student, we cannot conclude that the higher prevalence of textbook shortages has a direct relation to their school performance.*
- Factors such as the number of credentialed teachers, the level of parents' education, and students' transiency and socioeconomic status do appear to affect school performance.*
- LAUSD does not always spend its restricted textbook and other instructional materials funds appropriately, and it spends, on average, less per student than other large districts in the State for these resources.*

REPORT NUMBER 2001-124, JUNE 2002

Los Angeles Unified School District's response as of September 2003 and the California Department of Education's response as of June 2003

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to determine whether Los Angeles Unified School District's (LAUSD) program and policies regarding textbooks and other instructional materials result in a disparity in the quantity and quality of textbooks for a sample of high- and low-performing schools. The audit committee also requested that we do the following:

- Use our sample to determine if a correlation exists between demographic data, such as socioeconomic status and race, and the quantity and quality of the textbooks used by LAUSD schools.
- Identify funding sources that are available and those LAUSD uses to purchase textbooks and other instructional materials, and identify the total amount LAUSD spent on textbooks and other instructional materials for the past two years, review its process for allocating funds, and assess the amounts actually allocated to the schools in our sample.
- Compare LAUSD's average amount spent per student over the past two years for textbooks and other instructional materials to the amount spent by a representative sampling of school districts and the statewide average for all school districts.

- Determine whether publishers are providing free instructional materials to the same extent to all school districts and review LAUSD’s conflict-of-interest policy regarding the purchase of textbooks and other instructional materials to determine if it is consistent with the requirements of state law and whether LAUSD personnel follow the policy.

Although our audit of 16 LAUSD schools did not reveal any significant disparities in textbook quality and quantity among high- and low-performing schools, we did find students in both types of schools using outdated textbooks and that did not have a core subject textbook available for use in the classroom and at home. Moreover, other factors, such as teacher credentialing and student transiency, appear to have a greater impact on student academic performance. We also found that LAUSD can improve its management of textbook purchasing and inventories. Specifically, we found:

**Finding #1: Students do not always have sufficient textbooks.**

LAUSD policy requires that each student have a textbook in the core subjects for use in the classroom and at home. However, we found widespread use by LAUSD schools of textbooks restricted to the classroom and not available for students to take home, commonly referred to as class sets. Until LAUSD addresses its textbook shortages, it cannot ensure that each student in classes without textbooks receive the same instruction as their peers in classes that have textbooks for each student.

We recommended that to make sure that each student has the best opportunity to achieve academically, LAUSD enforce its existing policy.

***LAUSD Action: Corrective action taken.***

LAUSD reports that a checklist has been developed and that it is being used by textbook services staff to review the status of school sites in relation to the number of textbooks available. LAUSD assigned staff to ensure each school remains current with the policy of a textbook for each student in the core subject area.

**Finding #2: LAUSD is not fully complying with state law requiring school districts to annually certify that students have sufficient textbooks and/or instructional materials.**

State law requires school districts to hold a public hearing and to determine through a resolution, whether each student has or will have before the end of the fiscal year, in each subject area, sufficient textbooks and/or instructional materials that are consistent with the content and cycles of the curriculum framework adopted by the State Board of Education (state board). However, LAUSD's fiscal year 2000–01 certification was incomplete because LAUSD does not require its schools to certify for each subject adopted by the state board. Rather LAUSD has only required its schools to certify that they have sufficient textbooks in subjects that are consistent with the state board's most recent adoption cycle. Until it requires schools to certify in accordance with state law, LAUSD will be out of compliance with the law and will be unable to ensure that its students have sufficient textbooks.

We recommended that LAUSD require its schools to certify annually that each student has, or will have prior to the end of that fiscal year, in each subject area, sufficient textbooks and/or instructional materials that are consistent with the content and standards of the curriculum framework adopted by the state board.

***LAUSD Action: Corrective action taken.***

LAUSD provided evidence indicating that new procedures are in place that requires all schools to certify that they have sufficient materials in all subject areas falling under the content and curriculum frameworks adopted by the State. LAUSD's certifications began in April 2003.

**Finding #3: LAUSD's goal of a six to one student-to-computer ratio is inconsistent with its consultant's recommendation and best practices.**

In May 2000, LAUSD adopted a five-year instructional technology plan, which includes a goal of moving toward a student-to-computer ratio of six to one. However, this goal is inconsistent with a recommendation made by its consultant in 1998 that LAUSD adopt the maximum student-to-computer ratio for ideal learning of five to one. A June 2001 report issued by the

Chief Executive Officer Forum on Education Technology also indicates that a reasonable goal for the number of students per instructional computer is five or less.

We recommended that LAUSD consider adopting a student-to-computer ratio of five to one.



***LAUSD Action: None.***

LAUSD stated that it has no plans to move toward a student-to-computer ratio of 5-to-1, but does plan to continue to move toward a 6-to-1 ratio.

**Finding #4: LAUSD's low-performing schools have fewer teachers that possess a basic teaching credential than high-performing schools.**

Our analysis of LAUSD data for about 560 elementary, middle, and high schools for fiscal years 1999–2000 and 2000–01 revealed that LAUSD's low-performing schools generally have fewer fully credentialed teachers than its high-performing schools. A November 1997 report by the California Commission on Teacher Credentialing (commission) states that the quality of teachers is the single most important determinant of student success and achievement in school. As part of its Teaching As a Priority Program, LAUSD plans to (1) increase the number of teachers in its low-performing schools who possess basic credentials by providing stipends directly to teachers assigned or transferring to Academic Performance Index rank-1 schools and (2) issue recruitment and retention grants to the local districts so that they can tailor their efforts to local conditions. LAUSD also plans to contract with an external evaluator to measure the effectiveness of its efforts in recruiting and retaining credentialed teachers in LAUSD's low-performing schools using data collected over a three-year period.

We recommended that to increase the number of teachers who possess basic credentials in its low-performing schools, LAUSD continue its current recruitment and retention efforts and expand those efforts to include all financial incentives offered by the State or federal government. Further, LAUSD should review

the recommendations of its outside evaluator and implement those recommendations that will further increase its ability to recruit and retain teachers in low-performing schools.

***LAUSD Action: Partial corrective action taken.***

LAUSD reported that in October 2002 it implemented a fast track process for considering credentialed teacher applications and created a new on-line teacher application. LAUSD also stated that it developed a Teacher Quality Strategic Plan, which was approved in concept by the Los Angeles City Board of Education in March 2003 and is being implemented. LAUSD stated that it held a summit on February 21, 2003, so that it can continue to work with universities and colleges to increase the number of credentialed teachers assigned to LAUSD. Moreover, LAUSD reported that through its ongoing efforts to expand the number of teacher recruits from Teach for America and the New Teacher Project (NTP), it has increased the number of NTP teachers to 750 for fiscal year 2003–04. Finally, LAUSD reported that in March 2002 two external evaluators made recommendations on ways to improve its human resource and recruitment practices; however, LAUSD did not provide specifics on its intent to implement these recommendations.

**Finding #5: LAUSD does not always spend restricted textbook funds appropriately.**

LAUSD allocated a total of \$92 million in restricted Instructional Materials Fund (IMF) and Schiff-Bustamante Standards-Based Instructional Materials Program (Schiff-Bustamante) funds in fiscal year 2000–01 to its elementary, middle, and high schools. According to LAUSD accounting records, schools inappropriately spent \$16.2 million of these funds to purchase other books that are not part of the core curriculum, such as library books or test preparation workbooks and instructional materials. Further, our review of a sample of eight invoices found that school staff are not always using the correct accounting codes, which suggests that LAUSD cannot ensure that funds designated for purchasing textbooks are spent appropriately.

We recommended that LAUSD provide training to school accounting staff to ensure that they are aware of the proper accounting for textbook funds and conduct periodic monitoring of the use of state-restricted textbook and IMFs to ensure the uses are appropriate.

***LAUSD Action: Corrective action taken.***

LAUSD stated that it has provided training to the Local District Business Managers on the accounting for and use of state textbook funding and that these managers will conduct periodic reviews of textbook purchases. Additionally, they are working with local school site staff to ensure compliance with appropriate expenditure guidelines. Further, LAUSD will send letters to publishers regarding its procurement procedures, has listed terms and conditions on its purchase orders, and has linked commodity codes to textbooks so that purchases are stopped during the ordering process if inappropriate materials are being ordered.

**Finding #6: Publishers of textbooks and instructional materials are not treating all schools fairly.**

State law requires publishers to provide any instructional materials free of charge to school districts in California to the same extent as they provide them to any school district nationwide. The California Department of Education (department) refers to this law as the “most-favored-nations clause.” Some publishers are not equitably providing free instructional materials (commonly referred to as gratis items) to different schools within LAUSD, as state law requires. For example, during a review of only 15 invoices, we found two cases where schools did not receive the same gratis items from the same publisher for the same textbooks. In total, we found that four schools were shortchanged gratis items worth more than \$60,000. Unfortunately, the disparate treatment shown in our examples, as well as in any other cases that may exist, would most likely not be detected because neither LAUSD nor the State conducts any monitoring to ensure that publishers comply with the most-favored-nations clause.

To ensure that publishers are treating all California schools equitably, we recommended that the department modify its regulations or seek legislation, if necessary, to require publishers and manufacturers to report, at a minimum, all offers of free instructional materials for Kindergarten through grade 12 within 30 working days of the effective date of the offer. The department should also maintain a comprehensive Web site that contains this information and require publishers to report to the department in a standard electronic format. Further, the department should establish a hotline to receive complaints regarding unfair treatment and instruct school districts to

contact the hotline if they receive textbook prices or free materials that differ from those posted on the department's Web site. Finally, when necessary, the department should pursue cost recovery for any violations of the most-favored-nations clause and work with school districts to identify and remove any other obstacles that prevent them from effectively monitoring the most-favored-nations clause.

To ensure that its schools are treated fairly by publishers, we recommended that LAUSD ensure that school and local district staff involved in purchasing textbooks and other instructional materials are aware of the state law that requires publishers to treat schools equitably and have access to current publisher price and gratis item lists when placing orders. In addition, LAUSD should modify its accounting system to include standard book numbers and should collect damages from the publishers identified in our report for noncompliance with the most-favored-nations clause. Moreover, LAUSD should conduct periodic monitoring of the prices and gratis items publishers offer its schools for similar purchases and pursue cost recovery for any exceptions found. Finally, LAUSD should work with the department to identify and remove any other obstacles that prevent it from effectively monitoring the most-favored-nations clause.

***LAUSD Action: Partial corrective action taken.***

LAUSD reported that it has taken several steps to increase awareness of the most-favored-nations clause. For example, it has provided training to Local District Business Managers, revised its price lists and order forms, and sent letters to publishers requiring them to provide current information to schools at the time of order. LAUSD also reported that it will consider including ISBN numbers during the development of its new financial systems that it plans to implement over the next five years. LAUSD negotiations with publishers identified in our report are continuing and thus far it has identified \$1.8 million in gratis items discrepancies to schools. LAUSD reports that its Textbook Services Office, with the support of its general counsel and the department, are pursuing all exceptions found for cost recovery. LAUSD reported that it is participating in the department's Instructional Material Advisory Group on free and gratis items and is reporting violations to the State. To monitor publisher compliance with the most-favored-nations clause, LAUSD is implementing a process to periodically review a random sample of invoices.

***Department Action: Partial corrective action taken.***

Although the department did not address modifying its regulations or seeking legislation, it did report that it will continue to include a publishers' web link requirement in the Publishers' Invitations to Submit for future Kindergarten through grade eight adoptions. Due to reductions in its budget, the department stated that it has chosen to develop a complaint procedure form and place the form on its Web site instead of establishing a hotline. Further, the department stated that it plans to work with the state board to develop the appropriate legislation and administrative regulations to pursue cost recovery for any violations of the most-favored-nations clause. Finally, the department reported that it meets periodically with representatives of the Learning Resources Display Centers and has discussed the topic of improving information on gratis items. The department also stated that as no-cost improvements are identified and agreed to in these meetings they will be implemented.

**Finding #7: Central administration of textbook purchases might resolve several shortcomings.**

LAUSD might be able to resolve many of the shortcomings in its process for ordering textbooks if it centralizes this function. Specifically, LAUSD could reduce inappropriate charges against restricted state textbook funds, improve its payment record and ability to do business with preferred vendors, and ensure that schools receive the same gratis items from publishers.

We recommended that LAUSD consider centralizing its textbook-purchasing function at LAUSD or the local district level.

***LAUSD Action: Corrective action taken.***

In lieu of our recommendation, LAUSD stated that it has implemented new policies and procedures for ordering textbooks. Its Local District Purchasing Services Coordinators will oversee purchasing and ensure equitable treatment from publishers on gratis items. The coordinators will also track the timely delivery of shipments by publishers and the timely receipt of textbooks by schools.

**Finding #8: LAUSD’s textbook inventory system is not fully implemented.**

Between May 1999 and August 2000, LAUSD purchased, for almost \$2 million, an inventory system designed to monitor and account for textbooks and maintain data on textbook damage. Despite LAUSD’s considerable cost and effort to help schools implement the inventory system, we found that the system is not widely used. Ensuring that schools implement the system would enable LAUSD to monitor and account for its textbooks adequately so that each student has a textbook for all subjects. LAUSD would also be able to begin complying with a state law requiring it to publicly report information regarding the quality and currency of textbooks and instructional materials so that parents can make meaningful comparisons between public schools before enrolling their children. Although LAUSD’s Business, Finance, Audit, and Technology Committee lists the development of a centralized textbook inventory system as one of its technology projects, it reported in May 2002 that this project is not fully funded.

LAUSD should proceed with its plans to develop a centralized textbook inventory system. The system should include all texts and other instructional materials at each school and include ongoing standardized training and both implementation and technical support.

***LAUSD Action: Partial corrective action taken.***

LAUSD told us that it is proceeding with the implementation of a centralized inventory system and that three additional staff have been assigned to aid these efforts. LAUSD stated that the inventory system is being supported in the senior and middle schools. In addition, a temporary web-based central inventory system is in place and is being populated with inventory data until its new student information system, which will include textbook inventory data, is put in place.

**Finding #9: LAUSD can improve the way it holds students and parents accountable for lost or damaged textbooks.**

LAUSD’s inadequate system for tracking textbooks also diminishes the ability of some schools to ensure that students or their parents are accountable for lost or damaged textbooks. In addition, during our testing of 16 schools, we found

varying degrees of compliance with LAUSD's policy for student accountability. Consequently, schools may not be recovering as many textbooks or as much money as they could.

LAUSD should make sure that schools and local district staff are aware of and are complying with its student accountability policy for lost or damaged textbooks, including the maintenance of an accounting or inventory system that clearly identifies the student and the type of school property issued to the student.

***LAUSD Action: Pending.***

LAUSD reported that it is developing an accountability process to reduce textbook loss and damage rates. LAUSD will provide its local district staff with training and will then work with schools on this issue. Baseline loss rates have been determined so that it can measure progress at the middle and senior high schools each spring.

**Finding #10: LAUSD can strengthen its conflict-of-interest and disclosure code to include staff involved in textbook-purchasing decisions.**

LAUSD can further improve its controls over textbook purchasing by modifying its conflict-of-interest and disclosure code to require principals and members of textbook evaluation committees to complete an annual disclosure statement that would reveal any potential conflicts with textbook publishers or manufacturers. LAUSD's ethics officer told us that he expects to submit the most recently proposed revisions to the disclosure code for approval by the end of June 2002, which will include adding principals to the designated employee list. In addition, he told us that future proposals would include the results of LAUSD's continuous review of other district and school positions and their changing responsibilities to see if it is appropriate to add them to the list of designated positions. By strengthening its code, LAUSD can further reduce the risk of bias or the appearance of impropriety in the textbook adoption and purchasing process.

We recommended that LAUSD revise its conflict-of-interest and disclosure code to include principals and textbook evaluation committee members in its list of designated positions. In addition, LAUSD should continue its plan to review other district and school positions for inclusion in the code as designated positions.

***LAUSD Action: Partial corrective action taken.***

On October 21, 2003, the Los Angeles County Board of Supervisors approved revisions to LAUSD's conflict of interest and disclosure code (code). LAUSD made revisions to its code to add, delete, and change the titles of numerous positions due to organizational changes since its last revision. The LAUSD also created a new disclosure category for positions involved in employee relations. Our review of the code found that although LAUSD did include principals in its list of designated positions, it did not include textbook committee members.



# UNIVERSITY OF CALIFORNIA

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## ***Its Partnership Agreement Could Be Improved to Increase Its Accountability for State Funding***

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### **Audit Highlights . . .**

*Our review of the University of California's (university) partnership agreement revealed the following:*

- Of 22 objectives included in the agreement, 9 contain outcomes that identified quantifiable and clear targets to measure improved performance, and 13 do not. Thus, the university's ability to demonstrate its success in using state funds to achieve the objectives is limited.*
- The university's expenditures for support salaries increased at a faster rate than its expenditures for academic staff salaries within instruction, research, and public service between 1997 and 2001—two years before and three years after the partnership agreement went into effect.*
- Certain factors have an impact on the 4.8 primary course-to-faculty ratio the university agreed to maintain as part of the partnership agreement. For example, we found that 13 percent of the primary courses taught by regular-rank faculty had enrollments of two students or fewer.*

### **REPORT NUMBER 2001-130, JULY 2002**

#### **The University of California's response as of July 2003**

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct a comprehensive audit of the University of California's (university) performance under the partnership agreement. As part of the audit, the audit committee asked that we evaluate the effectiveness of the methods the university has established to allocate the increased state funding it receives and the procedures it has developed to measure campuses' performance in meeting the goals of the partnership agreement. In addition, it requested that we compare university expenditures before and after the partnership agreement to determine how the university has allocated and expended its increased state funding. Further, we were to determine whether the university has implemented a state-supported summer term with services similar to the regular academic year, and we were to analyze the university's annual Undergraduate Instruction and Faculty Teaching Activities report (instructional report) for the past three years and present conclusions reached on any trends we identified.

#### **Finding #1: The university cannot fully measure its accomplishments because the partnership agreement does not always establish measurable and clear targets.**

In May 2000, the university and the governor entered into a four-year partnership agreement encompassing fiscal years 1999–2000 through 2002–03. The overall intent of the agreement was to provide the university with funding stability in exchange for its progress toward meeting certain objectives included in the partnership agreement. As a result, although the Legislature is not a party to the partnership agreement, the Legislature and the governor appropriated additional state funds during the first two years of the partnership agreement that they expected the university to use, in combination with

existing resources provided by the State, to accomplish objectives identified in the partnership agreement. However, although the partnership agreement contains clear and measurable targets for some of the objectives it outlines, it does not contain such targets for many others. Therefore, the university's ability to demonstrate its success in using state funds to achieve the partnership agreement's objectives is limited.

Specifically, in our review of the 22 objectives specified in the partnership agreement, we found that only 9 contain outcomes that identify quantifiable and clear targets to measure improved performance. For the other 13 objectives, the partnership agreement does not identify clear and measurable targets, even when the objectives lend themselves to the establishment of such targets. For example, 1 objective states that beginning in 2001, the university should increase the percentage of students from low-participating high schools who enroll in the university. A target for this objective might identify a specific percentage and establish a deadline for the university to reach it, while stating that the university could revise these goals as circumstance warranted. However, the agreement contains no such target.

We recommended that the university propose establishing clear and measurable targets when preparing future partnership agreements. These targets should allow the university to better assess its success in meeting the objectives of the partnership agreement. In addition, if the university is concerned that it will be expected to meet a measurable target when it has not received the related funds or when factors outside its control impede its progress, it should propose that as circumstances change it can revise the targets.

We also recommended that the university confer with the governor and the Legislature to determine whether having the Legislature provide input on objectives and measurable targets for future partnership agreements might be beneficial.

***University Action: Pending.***

The university indicated that it would consider our recommendations relating to future partnership agreements if a new agreement is negotiated.

**Finding #2: The university has spent more of its increased state funding on support staff than on academic staff.**

Although the university's primary mission is to teach and conduct research in a wide range of disciplines and to provide public services, it increased its expenditures for support staff salaries made out of its general operating funds at a greater rate than it increased its expenditures for academic staff salaries within instruction, research, and public service between 1997 and 2001. Only 44 percent of its increase in salary expenditures during this time related to these academic salaries, while 56 percent related to support staff salaries. Moreover, the proportion of employees that the university hired in certain support classifications using general operating funds over the five-year period was much greater than those it hired in certain academic positions, despite its nearly 13 percent growth in enrollment. The majority of the increases in the university's expenditures occurred in five job classifications, four of which were support classifications. The number of full-time equivalent (FTE) professorial-tenure employees at the university grew by 504, or 10 percent, while the number of its FTEs within advising services increased by 532, or 59 percent, and the number of its FTEs within fiscal, management, and staff services increased by 2,075, or 43 percent.

The hiring of both academic and support staff may have contributed to achieving the partnership agreement objectives, and the university's hiring decisions may have appropriately reflected its needs. However, because the partnership agreement does not contain objectives or measurable targets that identify the areas in which the university believes growth in positions is necessary, the Legislature and the governor may not be able to evaluate whether the university's decisions reflect the intent of the agreement. The addition of such targets to the partnership agreement would increase the university's accountability for its use of state funds and would enable both the State and the university to better monitor the proportion of increased funding spent on academic and support salaries.

We recommended that the university confer with the governor and the Legislature to determine whether it would be beneficial to establish targets to evaluate how the growth in academic and support positions and spending are consistent with the priorities of the partnership agreement. For example, the university could establish targets that address the growth and positions it believes are needed in such categories as professorial-tenure faculty, other faculty, fiscal staff, clerical staff, and managers to meet

the objectives of the partnership agreement. In addition, the university should confer with the governor and the Legislature to determine whether it is beneficial for the university to report on the actual growth that has occurred compared to the targets.

***University Action: Pending.***

The university indicated that it would consider our recommendations relating to future partnership agreements if a new agreement is negotiated.

**Finding #3: Two factors have an impact on the primary course-to-faculty ratio.**

The university compiles certain ratios involving the teaching activities of regular-rank faculty in its annual instructional report, which responds to inquiries made by the Legislature and also addresses one of the objectives included in the partnership agreement. According to that objective, the university in effect agrees to maintain an average workload of 4.8 primary courses per faculty FTE per year. The university defines primary course as a regularly scheduled, unit-bearing course usually labeled as a lecture or seminar. The university's instructional report states that for academic year 1999–2000, the university's primary course-to-faculty ratio was 4.9, exceeding the agreement's requirement.

However, two factors have an impact on the primary course-to-faculty ratio. First, our analysis shows that one- and two-student primary courses represented 0.7 of the university's 4.9 ratio in academic year 1999–2000. Although no requirement exists regarding the minimum number of students in a primary course, having a significant number of small-enrollment primary courses could affect a student's ability to graduate in four years. Second, because Berkeley's faculty apparently teach more primary courses than the faculty at any other campuses when Berkeley's data are converted from a semester to a quarter basis, the higher number of courses taught by Berkeley's faculty affects the university-wide ratio. However, in the instructional report, the university does not discuss the impact of Berkeley's faculty teaching more primary courses.

To ensure that the Legislature and the governor have a complete understanding of the factors influencing the primary course-to-faculty ratio included in the instructional report, we recommended that the university disclose in its instructional report the workload of its regular-rank faculty by the number of students

enrolled in courses. In addition, it should disclose that Berkeley's faculty teach more primary courses on a quarter basis than the faculty of other campuses and should communicate the impact that Berkeley's data has on the university-wide ratio.

***University Action: Pending.***

The university stated that it plans to report information about class sizes for regular-rank faculty. It also indicated that future instructional reports would address the impact on the universitywide ratios of converting semester data to quarter equivalents.

**Finding #4: The campuses could not demonstrate that they correctly classified many of the one- to two-student primary courses we reviewed.**

Our analysis of a sample of the one- to two-student courses offered by the university in academic year 1999–2000 found that the campuses were unable to demonstrate that they had correctly classified 33 percent of them as primary courses. As discussed previously, the university defines primary courses as a regularly scheduled, unit-bearing course usually labeled as a lecture or seminar. On the other hand, independent study course is defined as a unit-bearing activity for which students receive credit toward their degree, but it is not regularly included in the schedule of courses and usually focuses on independent study or special projects by arrangement between a student and faculty member. Seminars and lectures typically have higher enrollments, whereas independent study courses involve one student or a small group of students. The university calculated the primary course-to-faculty ratio by dividing the total number of primary courses by the number of regular-rank FTE faculty. Therefore, if the campuses incorrectly classify primary courses as independent study courses or vice versa, it affects the accuracy of the ratio.

Although nothing precludes the university from providing primary courses with enrollments of only one- to two-students, we focused our review on these courses because we believed these courses were likely to have the highest risk of misclassification because independent study courses generally have low enrollments. We reviewed 240 primary courses with enrollments of only one to two students at the eight campuses that are included in the university's instructional report. We found that the campuses

were unable to provide sufficient support to demonstrate that they correctly classified 79, or 33 percent, of the 240 courses in our sample.

When we asked the university whether it offers guidance to the campuses or verifies the data used in the instructional report, the director of policy analysis responded that the university annually provides instructions and definitions for the campuses' uses in classifying courses. The director of policy analysis also stated that the university trusts the campuses to provide accurate information and does not verify the data included in the tables. However, we found the guidance the university provides to the campuses to be very general and subject to interpretation.

We recommended that the university perform the following actions:

- Clarify the definitions of primary course and independent study course in the instructions it provides to the campuses.
- Ensure that the campuses consistently interpret the definitions of primary course and independent study course by periodically reviewing the campuses' data for accuracy and consistency.
- Review more closely the existing classifications of courses and make corrections where appropriate. This review should include, but not be limited to, primary courses with low enrollments.

***University Action: Pending.***

The university stated that based on the recommendations of its Task Force on Faculty Instructional Activities (task force), it plans to report each course using the following categories: faculty-designed instruction, faculty-supervised group instruction, and faculty-supervised tutorial instruction. An implementation task force, which will include the Academic Senate and campus representatives, will work with staff from the university's Office of the President to develop clear operational definitions for each category. Finally, the university also indicated that it will periodically review the campuses' data and categorization of courses under the new reporting scheme for accuracy and consistency.

**Finding #5: The instructional report does not address the workload of non-regular-rank faculty and miscellaneous instructors.**

Non-regular-rank faculty and miscellaneous instructors—adjunct professors, lecturers, teaching assistants, retired faculty, and others—teach a significant number of the university’s primary and independent study courses. However, the partnership agreement does not address the workload ratios for non-regular-rank faculty and miscellaneous instructors, and the university does not address these staff in its workload-by-FTE table in the instructional report. We found that non-regular-rank faculty teach 30 percent of all primary courses and have a primary course-to-instructor ratio of 8.5. The miscellaneous instructors teach 16 percent of the primary courses, but we were unable to determine their workload ratio because the university’s system was not designed to capture certain data used to calculate the ratio.

In light of the partnership agreement’s objective of graduating students in four years or less, it would seem appropriate for the university to also provide the Legislature and the governor with information regarding the workload ratio for all of its instructors, not just its regular-rank faculty. In fact, the partnership agreement could be expanded to include objectives and measurable targets that specifically address the workload of these staff. The Legislature and the governor would then have a more complete picture of the workload of all instructors and could more appropriately evaluate that workload to determine whether fluctuations occur that may affect the ability of students to enroll in the classes they need to graduate.

We recommended that the university propose expanding future partnership agreements to include objectives and measurable targets that address workload ratios and course enrollment levels for all regular- and non-regular-rank faculty and miscellaneous instructors. Additionally, the university should disclose in its instructional report the course-to-faculty ratio for non-regular-rank faculty and the workload ratios for miscellaneous instructors. Similar to our recommendation for regular-rank faculty, the university should also disclose non-regular-rank faculty and miscellaneous instructor workloads by the number of students enrolled in courses.

Finally, to enable it to calculate and report the workload for miscellaneous instructors, the university should develop a method to capture the FTE data related to these instructors.

***University Action: Pending.***

The university stated that the recommendations relating to future partnership agreements will be a matter of negotiation with the governor. However, it indicated that in future reports on instructional activity, the university plans to include course-to-faculty ratios and information about class sizes for non-regular-rank faculty. Finally, the university stated that it considered carefully how best to capture the FTE associated with several groups of miscellaneous instructors and it has found that it can capture the FTE for some of the groups. However, it also indicated that for other individuals, such as professional staff researchers, it is impossible to determine the exact portion of their FTE related to instructional activities without an extensive audit of their time. Because of the expense associated with doing that, the university would prefer simply to report their instructional activities as a whole, rather than per FTE.

# CALIFORNIA'S CHARTER SCHOOLS

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## ***Oversight at All Levels Could Be Stronger to Ensure Charter Schools' Accountability***

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### ***Audit Highlights . . .***

*Oversight of charter schools at all levels could be stronger to ensure schools' accountability. Specifically:*

- The four chartering entities we reviewed do not ensure that their charter schools operate in a manner consistent with their charters.*
  - These chartering entities' fiscal monitoring of their charter schools is also weak.*
  - Some charter schools assess their educational programs against their charters' measurable student outcomes, but others do not.*
  - The Department of Education (department) could, but does not target its resources toward identifying and addressing charter schools' potential academic and fiscal deficiencies.*
  - Finally, although two new statutes attempt to add accountability, without the chartering entities and department increasing their commitment to monitoring, these new laws may not be as effective as they could be.*
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### **REPORT NUMBER 2002-104, NOVEMBER 2002**

#### **Chartering entities' and the California Department of Education's responses as of January 2004**

The California Legislature passed the Charter Schools Act of 1992 (Act) to provide opportunities for communities to establish and operate schools independently of the existing school district structure, including many of the laws that school districts are subject to. The Legislature intended charter schools to increase innovation and learning opportunities while being accountable for achieving measurable student outcomes. Before a charter school can open, a chartering entity must approve a petition from those seeking to establish the school. Under the Act, three types of entities—a school district, a county board of education, and the State Board of Education—have the authority to approve petitions for charter schools. As of March 2002, there were 360 charter schools serving approximately 131,000 students throughout California. More than 70 percent of the agencies chartering those schools have only one charter school. The Joint Legislative Audit Committee requested that we conduct a comprehensive audit of California's charter schools. We assessed the actions of the Fresno Unified School District (Fresno), Los Angeles Unified School District, Oakland Unified School District, San Diego City Unified School District, and the California Department of Education (department). Specifically, we found that:

#### **Finding #1: Chartering entities do not ensure that charter schools meet targeted student outcomes.**

In order to hold the charter schools accountable, the Legislature required that each charter petition contain certain elements, including measurable student outcomes proposed by the school to accomplish its educational program. These outcomes give the chartering entity criteria against which it can measure the school's academic performance and hold it accountable. Each

chartering entity we reviewed has interpreted its oversight responsibilities differently, typically developing some practices for overseeing charter schools. However, none of the chartering entities has adequately ensured that their charter schools are achieving the measurable student outcomes set forth in their charter agreements.

A school's charter represents an agreement between it and the chartering entity. The charter agreement is critical for accountability, as it outlines the standards the school is agreeing to be held to; therefore, we expected to find that chartering entities had established monitoring guidelines and activities to ensure that their charter schools were complying with their agreements. Although three of the four chartering entities we visited have chartered schools since 1993, and each has chartered at least eight schools, none had developed and implemented an adequate process to monitor their schools' academic performance. Without periodically monitoring their schools for compliance with the charter terms, the chartering entities cannot determine whether their charter schools are making progress in improving student learning as identified in their charters, nor are the chartering entities in a position to identify necessary corrective action or revocation.

To ensure that the chartering entities hold their charter schools accountable through oversight, the Legislature should consider amending the statute to make the chartering entities' oversight role and responsibilities explicit.

To ensure that charter schools are held accountable for the taxpayer funds they receive and demonstrate accountability for the measurable outcomes set forth in their charters, the chartering entities should consider developing and implementing policies and procedures for academic monitoring. At a minimum, the policies and procedures should outline the following:

- Types and frequency of the academic data charter schools should submit.
- Manner in which the chartering entity will review the academic data.
- Steps the chartering entity will take to initiate problem resolution.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

***Chartering Entity Action: Partial corrective action taken.***

Fresno Unified School District (Fresno) said that it has continued to conduct a comprehensive annual review of its charter schools and sought to refine and improve its monitoring process with increased emphasis on academic outcomes. Fresno noted that it is improving its charter petition review process and is expecting its Board of Education to approve formalized and expanded policies and regulations in early spring 2004.

Los Angeles Unified School District (Los Angeles) reported that it is in the process of devising a system to include those charter schools that use Los Angeles' testing services in its district data collection and analysis of state-mandated testing programs. Charter schools that do not use Los Angeles' testing services must submit their data annually. In addition, its Program Evaluation and Research Branch (PERB) will develop a system for charter school monitoring consistent with the legislative intent. PERB will continue to conduct charter school evaluations that coincide with a school's charter renewal.

Oakland Unified School District (Oakland) said it has developed a Memorandum of Understanding (MOU) that it intends to execute with each charter school in January 2004. Oakland described the MOU as informing its charter schools of Oakland's policies and procedures, reminding the charter schools of their obligations under federal and state laws, and reinforcing the charter as a binding agreement. In addition, Oakland reported that for monitoring the charter schools' academic health it has analyzed existing charter schools' measurable goals and communicated with charter schools seeking charter renewal where academic improvement is needed. In January and February 2004, Oakland intends to conduct a planning session with the charter schools regarding how the schools will monitor themselves and Oakland will evaluate their performance.

San Diego City Unified School District (San Diego) stated it has reviewed certain aspects of its charter schools' performance including participation in the standardized testing and reporting program and compliance with state

intervention program guidelines. In addition, San Diego reported that it has instituted a timeplan and process for completing its accountability framework, which the charter school principals accepted in December 2003, and is focusing on academic achievement when assessing charter renewals.

**Finding #2: Chartering entities do not ensure the schools' compliance with various legal requirements that are conditions of apportionment.**

Although exempt from many statutes, charter schools are still subject to at least three legal requirements as conditions for receiving state funds. These requirements include (1) hiring teachers who hold a Commission on Teacher Credentialing permit, except for teachers of non-core, non-college-prep courses; (2) offering, at minimum, the same number of instructional minutes as noncharter schools; and (3) certifying that students have participated in state testing programs in the same manner as other students attending public schools. Requirements 1 and 2 became conditions of receiving state funds beginning January 2002, whereas requirement 3 has been a condition of receiving state funds since January 2000. Since these requirements are conditions of apportionment, we expected to find that the chartering entities had established guidelines and activities to ensure compliance with these legal provisions. Most of the chartering entities we reviewed lack policies and sufficient procedures to validate that all of their charter schools have met these conditions of apportionment. Moreover, although the charter school statute requires an annual audit, these audits do not address all of the conditions set forth in the statute. By not verifying that all of their charter schools comply with these legal requirements, the chartering entities cannot be assured that their charter schools have satisfied the conditions of apportionment.

To ensure that their charter schools are meeting statutory conditions for receiving state funding, the chartering entities should verify these conditions through the schools' independent financial audits or some other means.



***Chartering Entity Action: Partial corrective action taken.***

Fresno did not address this recommendation.

Los Angeles noted that it will collect and assess its charter schools' academic testing data. In addition, Los Angeles is requiring its charter schools to submit their audited financial statements within four months of the fiscal year close and will review this information.

Oakland said that in October each year it collects teacher credential information and it is currently conducting a file review to ensure complete information. If Oakland's data is incomplete, it will send correction letters to the charter schools affected. Oakland expects to obtain in January 2004 from each charter school certification of the school's intent to comply with instructional requirements and a master schedule. Oakland plans to continue this process annually each October. With regard to statewide tests, Oakland reported that it provided its charter schools with detailed test information, and incorporated test requirements in its MOU. On an ongoing basis it will share test information and perform spot checks on testing days.

San Diego reported that it reviewed audits submitted to assess the degree to which attendance accounting is reviewed and presented a scope of audit template to its charter schools. San Diego also reported that it is revising its policy and guidelines for charters to incorporate more precise academic accountability language. In addition, San Diego has confirmed that all of its charter schools are participating in the standardized testing and reporting program and the credential status for all charter school teachers under contract for 2002–03.

**Finding #3: Chartering entities lack policies and procedures for sufficient fiscal monitoring and have not adequately monitored their charter schools.**

When chartering entities authorize the creation of a charter school, they accept the responsibility for monitoring its fiscal health. Without fiscal monitoring, charter schools are not held accountable for the taxpayer funds they receive nor will the chartering entity always know when they should require corrective action or revoke a charter. Despite the crucial need for consistent fiscal monitoring, we found that the chartering entities lacked policies and procedures for such monitoring and have not adequately monitored their charter schools' fiscal

health, even though some charter schools appear to have fiscal problems. The four chartering entities we reviewed could not demonstrate that they always receive the financial information they request. Moreover, although all four chartering entities asserted that they have procedures for reviewing fiscal data and identifying and resolving problems, none could provide evidence of such. Further, even though all four chartering entities recently developed or adopted new policies and procedures regarding charter schools, only two of those policies address fiscal monitoring and appear to provide for improved monitoring of the chartering entities' charter schools' fiscal health.

Having an audit and correcting noted deficiencies are ways charter schools demonstrate accountability for the taxpayer funds they are entrusted with. Although each charter must specify the manner in which annual independent financial audits shall be conducted, not all audit reports contain all the information relevant to school operations. We expected the chartering entities to have policies and procedures in place for reviewing the audit reports of their charter schools to determine the significance of any audit findings and for ensuring that the schools resolved reported problems. However, some entities did not adequately review the reports and ensure that reported problems were resolved.

To ensure that charter schools are held accountable for the taxpayer funds that they receive and that they operate in a fiscally sound manner, the chartering entities should consider developing and implementing policies and procedures for fiscal monitoring. At a minimum, the policies and procedures should outline the following:

- Types and frequency of fiscal data charter schools should submit, including audited financial statements, along with consequences if the schools fail to comply.
- Manner in which the chartering entity will review the financial data, including the schools' audited financial statements.
- Financial indicators of a school with fiscal problems.
- Steps the chartering entity will take to initiate problem resolution or to ensure that reported audit findings are adequately resolved.

***Chartering Entity Action: Partial corrective action taken.***

Fresno stated that its annual review includes monitoring of the charter schools' fiscal condition. Fresno also mentioned that it enforces MOUs with each charter school, which require a charter school to comply with fiscal monitoring processes. Fresno cited its charter petition review process, which includes a review of a charter school's initial fiscal plans and documents. Fresno noted that it is developing more formalized and expanded procedures, with board consideration and approval expected in early spring 2004.

Los Angeles' fiscal policies require the charter schools to submit audited financial statements and three fiscal reports. Los Angeles will review budget and fiscal data and require the school to respond appropriately to any concerns identified. If the school does not submit the required reports or address Los Angeles' concerns, Los Angeles will initiate charter revocation proceedings.

Oakland referred to its MOU and it outlined the types and frequency of fiscal data the charter schools should submit, including audited financial statements, proposed budgets, interim financial reports, and an unaudited full-year report. Oakland plans to implement these requirements in February 2004 following receipt of the signed MOUs. Oakland also stated that it is adapting another district's assessment grid that outlines financial indicators and Oakland will implement this in February 2004. Finally, Oakland stated that it would initiate a revocation process when necessary.

San Diego stated that its school board approved an MOU for all charter schools that articulates the type, frequency, content, and comprehensiveness of fiscal information each school must submit. In addition, San Diego has addressed certain schools' fiscal performance on a case-by-case basis, including implementation of a fiscal watch process.

**Finding #4: Chartering entities cannot justify the oversight fees they charge and risk double-charging the State through mandated-costs claims.**

For fiscal years 1999–2000 and 2000–01, the four chartering entities charged their charter schools more than \$2 million in oversight fees. Nevertheless, none of the four chartering entities could document that the fees they charged corresponded to their actual

costs in accordance with statute, because they failed to track their actual oversight costs. As a result, the chartering entities may be charging their charter schools more than permitted by law.

Moreover, these chartering entities also participated in the State's mandated-costs reimbursement process, which reimburses entities for the costs of implementing state legislation. The chartering entities claimed costs in excess of \$1.2 million related to charter schools for the two fiscal years we reviewed. However, because the chartering entities did not track the actual costs associated with overseeing their charter schools, they risk double-charging the State.

Although the statute is clear that the entities' oversight fee is capped at a certain percentage of a school's revenue based on actual costs, it is unclear regarding which revenues are subject to the oversight fee. Consequently, the chartering entities are interpreting the law differently and may be applying the percentage to more revenues than permitted or to fewer revenues than they could be to cover their oversight costs.

To ensure that chartering entities can justify the oversight fee they charge their charter schools and to minimize the risk of double-charging the State for the costs of charter school oversight, they should:

- Establish a process to analyze their actual costs of charter school oversight.
- Compare the actual costs of oversight to the fees charged and, if necessary, return any excess fees charged.
- Use the mandated-costs reimbursement process as appropriate to recover their unreimbursed costs of overseeing charter schools.

To ensure that the chartering entities charge their oversight fees appropriately, the Legislature should consider clarifying the law to define the types of charter school revenues that are subject to the chartering entities' oversight fees.

***Chartering Entity Action: Partial corrective action taken.***

Fresno said that it is verifying all allocated personnel time charges included in its oversight fee and its mandated cost claim. Fresno stated that it is reviewing mandate revenue it has received and will return to the State any funds it has received that were included in its charter school oversight fee.

Los Angeles reported that it will define specific oversight responsibilities and the estimated costs. In addition, it is setting up tracking systems to capture oversight expenditures and will compare these costs to the fees its charter schools pay. If appropriate, Los Angeles will use the mandated cost recovery process.

Oakland stated that it determined that the costs of past oversight far exceeded the revenue collected from its 1 percent oversight fee. In addition, Oakland said it plans to create a process by July 2004 to identify actual costs to present this information to its charter schools.

San Diego reported that it has established a process to verify and publish the actual costs of oversight and, where expenses are less than the percentage charged a charter school, San Diego has agreed to refund the possible excess.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

**Finding #5: The department could use existing data to identify fiscally or academically struggling charter schools and then question the responsible chartering entities.**

The department plays a role in the accountability of charter schools. The department has the authority to recommend that the State Board of Education take action, including but not limited to charter revocation, if the department finds, for example, evidence of the charter school committing gross financial mismanagement, or substantial and sustained departure from measurably successful academic practices. Although the chartering entity is the primary monitor of a charter school's financial and academic health, the department has the authority to make reasonable inquiries and requests for information. It currently uses this authority to contact a chartering entity if it has received complaints about a charter school.

If the department reviewed the financial and academic information that it currently receives regarding charter schools and raised questions with the chartering entities regarding charter schools' fiscal or academic practices, the department could target its resources toward identifying and addressing potential academic and fiscal deficiencies. In this way, it would provide a safety net for certain types of risks related to charter schools. The concept of the State as a safety net is consistent with the California Constitution, which the courts have found places on the State the ultimate responsibility to maintain the public school system and to ensure that students are provided equal educational opportunities. However, the department does not target its resources toward identifying and addressing charter schools' potential academic and fiscal deficiencies.

To fulfill its role as a safety net, the department should review available financial and academic information and identify charter schools that are struggling. The department should then raise questions with the schools' chartering entities as a way of ensuring that the schools' problems do not go uncorrected.

***Department Action: None.***



As stated in its initial response to our audit, the department continues to disagree with our audit's premise. In its one-year response to our audit report, the department stated that it is continuing to use its established complaint and inquiry process and will notify a charter-authorizing entity when information suggests a charter school may be struggling. The department described its action as a strategic and efficient method of intervention on a case-by-case basis.

**Finding #6: The department does not plan to review audits submitted under Senate Bill 740 to identify fiscally deficient charter schools.**

Senate Bill 740 (Chapter 892, Statutes of 2001) requires each charter school to submit to its chartering entity and the department, by December 15 of each year, an independent financial audit following generally accepted accounting principles. Although not specifically required by the law, we expected the department to plan to review the audits required by Senate Bill 740 in order to raise questions with chartering entities about how they were working with charter schools to

resolve the schools' fiscal deficiencies. However, the department does not plan to systematically review charter schools' audits for this purpose. The department will collect but not review the charter schools' audit reports, data which helps reflect the schools' accountability for taxpayer funds.

The department should take the necessary steps to fully implement Senate Bill 740, including reviewing audit exceptions contained in each charter school's audit report and taking the necessary and appropriate steps to resolve them.

***Department Action: Partial corrective action taken.***

The department stated that Senate Bill 740 does not require it to review charter schools' audit reports. The department said that it is implementing all statutorily required activities under this bill, including processing funding determinations, adjusting apportionments, administering the Charter Schools Facilities Grant program, staffing the Advisory Commission on Charter Schools, and ensuring the Kindergarten through grade 12 audit guide includes audit procedures for elements specified in Senate Bill 740. The department also noted that with the passage of Assembly Bill 2834 (Chapter 1124, Statutes of 2002), it received a position to review charter school audit reports and ensure audit findings are resolved.

**Finding #7: The department cannot assure that apportionments to charter schools are accurate.**

Although the department apportions charter school funds on the basis of average daily attendance (ADA), its apportionment process is faulty because it relies primarily on the certifying signatures of school districts and county offices of education—both of which lack the necessary procedures to ensure that charter schools comply with apportionment requirements. As a result, the department cannot be assured that charter schools have met the apportionment conditions the Legislature has established and receive only the public funds to which they are legally entitled.

So that it does not improperly fund charter schools, the department should work with the appropriate organizations to ensure that charter schools' reported ADA is verified through an independent audit or other appropriate means and that charter schools have met other statutory conditions of apportionment.

***Department Action: None.***

In its initial response to the audit report, the department said it disagreed with the finding related to this recommendation. Similarly, in its one-year response, the department said that it is relying on its processes, such as the certification process to verify ADA and that it follows up on concerns regarding charter schools' ADA. The department mentioned Senate Bill 740 and its requirement to ensure that the Kindergarten through grade 12 audit guide includes procedures for auditing charter schools related to nonclassroom-based instruction and that the department expects these procedures to be included in the audit guide for fiscal year 2003–04.

**Finding #8: Statutory guidance for disposing of a revoked charter school's assets and liabilities is unclear.**

In January 2002 Fresno revoked the charter for Gateway Charter Academy (Gateway). After its revocation action, Fresno sought the department's guidance regarding the disposition of Gateway's assets and liabilities. Fresno's concerns, covering a variety of financial issues, highlight a policy gap regarding a chartering entity's authority following a charter revocation—authority that statutes do not clearly address. For example, Fresno asked for clarification of its role in accounting for and recovering Gateway's assets, particularly since Gateway was no longer a public entity. In addition, Fresno lacked an understanding of how to respond to Gateway's creditors, who were seeking repayment of liabilities. Without established procedures for recovering public assets and addressing potential liabilities, including a clearly defined division of responsibilities assigned to the department and the chartering entity, the State may be unable to reclaim taxpayer-funded assets. Although the recent enactment of Assembly Bill 1994 (Chapter 1058, Statutes of 2002) requires a school's charter to specify closeout procedures, a policy gap remains regarding revoked or closed charter schools.

To ensure that a charter school's assets and liabilities are disposed of properly when it closes or its charter is revoked, the Legislature may wish to consider establishing a method for disposing of the school's assets and liabilities and requiring the department to adopt regulations regarding this process.

***Legislative Action: Unknown.***

In September, 2002, the Legislature passed and the governor signed Assembly Bill 1994 (Chapter 1058, Statutes of 2002). This bill amended the Education Code, Section 47605, to require charter petitions to include a description of the procedures to be used if the charter school closes, including plans for the disposition of any of the school's net assets. The department stated it has no statutory authority to dispose of a charter school's assets or pay its debts.

**Finding #9: Recent changes to charter school law may not completely answer existing questions about accountability.**

During its 2001–02 session, the Legislature approved two charter school bills that address some of the issues we raise in our report. Senate Bill 1709, signed into law on August 12, 2002, expands the number of entities to which charter schools—beginning in 2003—must submit by December 15 of each year copies of their annual independent financial audit reports for the preceding fiscal year. However, as we discussed earlier, the department's recent inclusion as a recipient of charter schools' audit reports may not necessarily lead to greater accountability or awareness of charter schools' fiscal health, unless the department reviews the audit reports.

Assembly Bill 1994, signed on September 29, 2002, provides both technical and substantive changes to the charter schools law. For example, this bill requires charter schools, through the county superintendent, to submit an annual statement of all receipts and expenditures (annual statement) from the preceding fiscal year. The annual statements must follow a format prescribed by the department. Furthermore, the bill requires that each county superintendent verify the mathematical accuracy of the charter schools' annual statements before submitting them to the department. These annual statements provide both chartering agencies and the department with additional financial data to assess the fiscal health of charter schools. However, the chartering agencies are not adequately reviewing the financial records and audit reports they already receive. In addition, the department does not use currently available funding data to identify potentially struggling charter schools in order to raise questions with chartering agencies. As a result, without an increased commitment by chartering agencies and the department to monitor charter schools, the level of accountability will not reach its full potential as provided for in the statute.



# CALIFORNIA'S EDUCATION INSTITUTIONS

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## ***A Lack of Guidance Results in Their Inaccurate or Inconsistent Reporting of Campus Crime Statistics***

REPORT NUMBER 2002-032, DECEMBER 2003

California education institutions' and the California Postsecondary Education Commission's responses as of December 2003

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### ***Audit Highlights . . .***

*Our review of California's education institutions' compliance with the Jeanne Clery Disclosure of Campus Security Policy and Campus Crime Statistics Act (Clery Act) revealed the following:*

- The Clery Act does not always provide clear definitions.*
  - Institutions sometimes report inaccurate or incomplete statistics in their annual reports.*
  - Institutions have significant discretion in identifying reportable locations.*
  - Institutions do not always request sufficient detail on crimes from campus security authorities and police agencies to avoid duplication or exclusion of a reportable incident.*
  - Not all institutions disclose required campus security policies and notify current students and employees of the annual reports' availability.*
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Chapter 804, Statutes of 2002, requires the Bureau of State Audits (bureau) to report to the Legislature the results of its audit of not less than six California postsecondary education institutions (institutions) that receive federal student aid. The bureau was also directed to evaluate the accuracy of the institutions' statistics and the procedures they use to identify, gather, and track data for publishing, disseminating, and reporting accurate crime statistics in compliance with the requirements of the Jeanne Clery Disclosure of Campus Security Policy and Campus Crime Statistics Act (Clery Act). We evaluated compliance with the Clery Act at California State University, Sacramento (Sacramento); City College of San Francisco (San Francisco); San Diego State University (San Diego); University of California, Davis (Davis); University of California, Santa Barbara (Santa Barbara); and University of Southern California (USC).

Chapter 804, Statutes of 2002, also requires the California Postsecondary Education Commission (Commission) to provide on its Internet Web site a link to the Internet Web site of each California institution of higher education that includes on that Web site the institutions' criminal statistics information.

### **Finding #1: Institutions receive little guidance on converting California's definitions of crimes to Clery Act reportable crimes.**

The Clery Act requires eligible institutions to compile crime statistics in accordance with the definitions used in the uniform crime reporting system of the United States Department of

Justice, Federal Bureau of Investigation (FBI). Definitions for crimes reportable under the Clery Act can be found in both the FBI's Uniform Crime Reporting Handbook (handbook) and federal regulations. If the United States Department of Education (Education) finds that institutions have substantially misrepresented their crime statistics, it may impose a civil penalty of up to \$25,000 for each violation or misrepresentation and may suspend or terminate the institution's eligibility status for Title IV funding. Although some state and federal entities provide limited guidance to some institutions, it appears that no single governing body exists within California to provide guidance to all institutions required to comply with the Clery Act on such matters as converting California's definitions of crimes to those reportable under the Clery Act. This lack of comprehensive guidance can result in the inconsistent reporting of crime statistics by the institutions and exposes them to Education's penalties.

To provide additional guidance to California institutions for complying with the Clery Act, the Legislature should consider creating a task force to perform the following functions:

- Compile a comprehensive list converting crimes defined in California's laws to Clery Act reportable crimes.
- Issue guidance to assist institutions in defining campus, noncampus, and public property locations, including guidelines for including or excluding crimes occurring at other institutions.
- Obtain concurrence from Education on all agreements reached.
- Evaluate the pros and cons of establishing a governing body to oversee institutions' compliance with the Clery Act.

***Legislative Action: Unknown.***

**Finding #2: Some institutions do not maintain documentation of the incidents they include in their annual reports and others inaccurately report the number of incidents.**

The six institutions we visited have established procedures to capture what each institution believes are reasonably complete crime statistics. Although the *Federal Student Aid Handbook* requires institutions to retain records used to create their annual reports, including the crime statistics, for three years after the

due date of the report, only Sacramento retained documentation to identify the specific incidents that were included in its 2002 annual report. San Diego was only able to provide documentation to identify the specific incidents it reported for calendar years 1999 and 2001. We were able to re-create the statistics for San Francisco using data from crime reports and other relevant documents. Davis, Santa Barbara, and USC did not maintain their documentation in a manner that would allow us to identify the specific incidents included in their annual reports; however, Davis and Santa Barbara chose to re-create their statistics. We were unable to re-create and verify the statistics for USC. According to our analysis, institutions mostly over-reported their crime statistics. However, except for Davis and San Francisco, the percentage of error was generally small.

To improve the accuracy and completeness of their data, we recommended that five of the six institutions retain adequate documentation that specifically identifies the incidents they include in their annual reports.

***Institutions' Actions: Pending.***

The education institutions generally agreed with our recommendation and included plans to implement either systems or methods to retain adequate documentation of the incidents they include in their annual reports.

**Finding #3: Institutions do not always have an adequate process for accurately identifying crimes at reportable locations.**

To comply with the Clery Act requirement for reporting the statistics for crimes occurring in or on noncampus buildings and property, and on public property, institutions must determine which locations meet the Clery Act definitions of noncampus and public property. Two of the six institutions we visited did not have a sufficient process for identifying all reportable noncampus locations in their statistics. Another institution did not differentiate in its annual report, crimes occurring on campus from those occurring at public property locations, such as streets surrounding the campus. When institutions do not adequately capture and report statistics for all noncampus and public property locations, they risk distorting actual levels of crime.

To improve the accuracy and completeness of their data, we recommended that four of the six institutions should establish procedures to ensure that they accurately identify all reportable locations and report all associated incidents.

*Institutions' Actions: Pending.*

The education institutions generally agreed with our recommendation and included plans to implement policies and procedures to ensure that they identify all reportable locations and report all associated incidents.

**Finding #4: Collecting insufficient information from campus security authorities and police agencies can lead to other errors.**

The Clery Act requires institutions to collect crime statistics from campus security authorities and state or local police agencies (police agencies). However, the institutions did not always collect sufficient detail, such as the time, date, location, and nature of an incident, to determine if the incidents are reportable. Specific details of an incident aid in verifying whether it is reportable and whether the same crime has been reported by more than one of its sources. Institutions that do not collect sufficient detail on an incident may over-report actual crimes by counting an incident more than once.

To improve the accuracy and completeness of their data, we recommended that three of the six institutions should establish procedures to obtain sufficient information from campus security authorities and police agencies to determine the nature, date, and location of incidents.

*Institutions' Actions: Pending.*

The education institutions generally agreed with our recommendation and included plans to request sufficient information on incidents, including the nature, date, and location of the incident.

**Finding #5: Institutions do not always comply with Clery Act requirements.**

The Clery Act outlines numerous campus security policies that institutions must disclose in their annual reports. Although most of the institutions make reasonable efforts to disclose their policies, they can do more to ensure compliance with all statutory requirements. The Clery Act and federal regulations also require institutions to distribute their annual reports to enrolled students and current employees and to notify prospective students and employees of the availability of the annual report. San Francisco is the only one of the

six institutions we reviewed that does not do so. In addition, the Clery Act requires that institutions make timely reports to the campus community on Clery Act reportable crimes considered a threat to other students and employees. However, only one of the six institutions established a time frame to report incidents to the campus community.

To improve the accuracy and completeness of their data, we recommended that three of the six institutions should establish procedures to include all required campus security policies in their annual reports. Further, we recommended that two institutions should establish procedures to notify all current and prospective students and employees of the reports' availability. Finally, we recommended that five of the six institutions should establish a policy to define timely warning and establish procedures to ensure that they provide timely warnings when threats to campus safety occur.

***Institutions' Actions: Partial corrective action taken.***

The education institutions generally agreed with our recommendations and stated that they will make the necessary changes to correct the deficiencies noted in our report.

However, only four of the five institutions agreed with our recommendation concerning timely warnings and included plans to implement a policy. Santa Barbara does not believe that it should establish a policy to define what it considers a timely response for disseminating information to the campus community on Clery Act reportable crimes considered to be a threat to other students and employees. This is because Education has stated that it is not necessary to define timely reports. However, Education also stated that campus security authorities should consult their local law enforcement agencies for guidance. Thus, nothing precludes Santa Barbara from implementing our recommendation to establish a policy to define timely warnings.

**Finding #6: The Commission's Web site does not link users to the institutions' Web sites.**

State law requires the Commission to provide a link to the Web site of each California institution containing criminal statistics information. However, as of September 4, 2003, the Commission's Web site did not include links to almost 300 campuses listed on the Web site of Education's Office of

Postsecondary Education. The Commission believes that it would need assistance from the Bureau for Private Postsecondary and Vocational Education in the Department of Consumer Affairs to maintain a comprehensive list of institutions and their Web sites. Without such a list, the Commission is unable to provide links to the Web site of each institution, as state law requires.

To ensure that it provides links to the Web site of each California institution that includes on that Web site criminal statistics, the Commission should work with the Bureau for Private Postsecondary and Vocational Education in the Department of Consumer Affairs to update its Web site. Additionally, the Commission should periodically reconcile its Web site to the federal Web site.

***Commission Action: Partial corrective action taken.***

The Commission stated that it is working with the Bureau for Private Postsecondary and Vocational Education to ensure that all links are included on the Commission's Web site. Further, the Commission reported that it will regularly check with Education to ensure that it has complete information. Finally, the Commission stated that it has updated its Web site to include links to all California institutions on Education's Web site.

# DEAF AND DISABLED TELECOMMUNICATIONS PROGRAM

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## ***Insufficient Monitoring of Surcharge Revenues Combined With Imprudent Use of Public Funds Leave Less Money Available for Program Services***

REPORT NUMBER 2001-123, JULY 2002

California Public Utilities Commission's and Deaf and Disabled Telecommunications Program's responses as of August 2003

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### *Audit Highlights . . .*

*Our review of the Deaf and Disabled Telecommunications Program (DDTP) concludes that:*

- Neither the DDTP nor the California Public Utilities Commission (CPUC) is fulfilling its responsibilities to ensure that telephone companies (carriers) are remitting required surcharges, possibly resulting in hundreds of thousands of dollars going uncollected.*
  - Only about 32 percent of certified carriers remitted surcharge payments over the last two years.*
  - Some of the DDTP's expenditures are for unreasonable or unnecessary items.*
  - The salaries of select DDTP employees average 24 percent higher than those of comparable state positions.*
  - Most DDTP contracts we reviewed comply with the Public Contract Code and contain adequate standards for contractors to adhere to.*
- 

The Joint Legislative Audit Committee requested that we conduct an audit of the Deaf and Disabled Telecommunications Program (DDTP) and California Public Utilities Commission's (CPUC) accounting controls to determine whether they are sufficient to ensure the proper accounting of program revenues and expenditures. We were also asked to assess the DDTP's procedures for ensuring that its contracting practices comply with Public Contract Code and its methods for ensuring that the scope of its contracted work is sufficient, meets the needs of its customers, and is cost effective.

We determined that neither the DDTP nor the CPUC is fulfilling its responsibilities to ensure that telephone companies (carriers) are collecting and remitting required surcharges on intrastate telecommunications charges, possibly resulting in hundreds of thousands of dollars going uncollected. Moreover, the DDTP does not always further its mission when expending public funds, potentially leaving less money available for program services.

### **Finding #1: Neither the DDTP nor the CPUC maintain a reliable record of carriers that are providing services subject to the surcharge.**

Although the DDTP and the CPUC share responsibility for ensuring that all mandated surcharges are remitted to the Deaf Equipment Acquisition Fund (DEAF) Trust, neither entity has a firm grasp on which carriers should be collecting and remitting these surcharges. As of April 2002, the CPUC's list of active carriers—or those currently certified to operate and/or provide telecommunications services in California—totaled 1,483. At least 68 percent of the carriers on the CPUC's active list did not remit surcharge revenue for 2000 or 2001. However,

the CPUC is not sure how many or which of these carriers are actively providing the intrastate services that are subject to the surcharge. Consequently, the CPUC could provide no definitive reason for why these carriers did not remit during the past two years. Some options include (1) they do not provide services subject to the surcharge, (2) they stopped operating before January 2000 or did not begin operating until after December 2001, (3) they do not collect the surcharge from their customers, or (4) they simply do not remit the surcharges they collect. No one knows for sure what the reason is. In any event, it is likely that some, if not many, of these carriers should be submitting surcharge revenue.

We recommended that the DDTP work with the CPUC to develop and maintain a reliable record of carriers that are providing services subject to the surcharge. We also recommended that the CPUC should require that all active carriers that do not submit surcharge revenues certify that they in fact do not provide services subject to the surcharge.

***DDTP and CPUC Action: Partial corrective action taken.***

As of January 1, 2003, CPUC staff assumed responsibility for developing and maintaining a reliable record of carriers providing services and monitoring the payment history of these carriers. The CPUC secured a programming vendor to develop a Telecommunications Carrier Surcharge Database, which encompasses all functions of carrier activity, including carrier reporting and carrier remittance monitoring. The database reviews bank deposits to ensure carriers' monthly reporting of their billings that are subject to surcharges as well as to determine the correct payment of surcharges by the carriers. Further, the CPUC stated it has improved its own Telecommunications Division Carrier Database, which currently has 1,758 licensed telecommunications carriers. The CPUC flagged 368 carriers as having invalid mailing addresses and will investigate these carriers for compliance with CPUC orders. The CPUC did not specifically comment on our recommendation that it should require all carriers that do not submit surcharge revenues certify that they in fact do not provide services subject to the surcharge.

**Finding #2: The DDTP does not adequately review or record the payments it receives.**

The DDTP is responsible for reviewing incoming transmittal forms, which detail remittances, and for maintaining an accurate record of payments so it can recognize which carriers have not remitted as frequently as required. Although the DDTP receives transmittal forms, it does little more than a cursory spot check of these forms before filing them away. In addition to not reviewing these forms adequately, the DDTP does not maintain an accurate record of payments or a payment history of carriers. As a result, it has been remiss in identifying both small and large carriers that have missed payments, potentially resulting in hundreds of thousands of dollars of uncollected funds. For example, the DDTP did not recognize that one large carrier missed submitting a payment for June 2000. As of April 2002, the carrier still had not submitted the payment, which—if similar to subsequent payments—should have been approximately \$200,000. Also, because the DDTP does not maintain accurate records based on the transmittal records it receives, it is unable to investigate potential discrepancies between the information recorded on the transmittal form and that in the DEAF Trust statements provided by the Bank of America, leaving potential errors unspotted.

We recommended that the DDTP track the payment history of each carrier and monitor these records to identify delinquent carriers. Also, beginning on July 1, 2003, the CPUC will ultimately be responsible for ensuring that it collects all surcharges. Thus, the CPUC will also have to monitor payment history records to ensure that carriers are remitting surcharges as required.

***CPUC Action: Corrective action taken.***

In order to effectively monitor surcharges remitted by carriers, the CPUC secured a programming vendor to develop a Telecommunications Carrier Surcharge Database. As described in corrective action for Finding 1, this database is to assist in carrier reporting and carrier remittance monitoring. The database reviews bank deposits to ensure carriers' monthly reporting of their billings that are subject to surcharges as well as determines the correct payment of surcharges by the carriers.

**Finding #3: The DDTP does not identify late payments or report them to the CPUC.**

The DDTP is to send out past-due notices to carriers when they have failed to remit as required and contact the CPUC concerning all delinquent surcharges. However, the DDTP does not carry out any of these procedures. Although the CPUC has ultimate enforcement power, the DDTP neither tracks which carriers are late in submitting payments nor confirms that the carriers are remitting the appropriate late-payment penalty. As a result, large amounts of revenue in the form of late-payment penalties go uncollected, and the DDTP has missed out on thousands of dollars of revenue that could be used to provide services to the deaf and disabled communities. For example, one large carrier failed to submit surcharge remittances for September and October 2001. When it finally did so on April 2, 2002—142 and 111 days late, respectively—the carrier did not submit any late-payment penalties, which should have been almost \$31,000.

We recommended that the DDTP regularly notify delinquent carriers and the CPUC of all past-due amounts. We also recommended to the CPUC that it enforce late-payment penalties.

***CPUC Action: Partial corrective action taken.***

The CPUC stated that it continues to endorse the enforcement of late penalties and carrier certification of nonservice. Over the past year, the CPUC developed a checklist of requirements, which are placed on each carrier and imposed by the CPUC in the carrier's grant of authority. These requirements cover, among others, whether the carrier is subject to surcharge and whether it must file a written acceptance letter. According to the CPUC, having this information allows it to evaluate its expectations against carrier performance and to take actions to revoke the authority of nonperforming carriers. After reviewing the requirements of each carrier, the CPUC relayed this information to the Administrative Law Judge Division, and communicated the compliance requirements to all carriers, allowing for carrier follow-up. Nonresponsive carriers were listed in a 30-day notice period in the CPUC's daily calendar to alert them to the potential for the CPUC to revoke their authority.

In the first eight months of 2003, 16 licensed carriers contacted the CPUC on their own volition to ask the CPUC to take back the authority it had granted to the carrier to do business in California. In addition, the CPUC revoked another 135 licenses. To do so, the CPUC identifies carriers that are nonperforming according to the requirements mentioned above. After a due process, the CPUC typically revokes the authority of these carriers. In most of these cases, these carriers are no longer in business and simply do not respond to official communications, telephone calls, etc.

Lastly, we mentioned earlier that the CPUC secured a programming vendor to develop a Telecommunications Carrier Surcharge Database. The vendor will also develop a program that will monitor the database for carriers that have not reported Total Intrastate Billings Subject to Surcharge for a particular month. The program will also monitor for underpayment of surcharges by carriers. A letter will be sent to the carrier to resolve each outstanding problem.

**Finding #4: The CPUC could improve its oversight of the DDTP and the program.**

The CPUC, despite being the governing body over the program and the DDTP, does not always demonstrate consistent oversight over the carriers or the revenue collection functions performed by the DDTP. For example, the CPUC does not ensure that carriers are following its instructions regarding the collection and remittance of surcharge revenues. Specifically, we found that carriers did not consistently apply the surcharges to the different types of intrastate service charges. In addition, carriers apply different methods when reporting and paying late-payment penalties. This may be occurring because the guidance provided by the CPUC is not detailed enough. As a result, there is a great deal of inconsistency and inefficiency in the surcharge process.

Also, the CPUC is beginning to conduct remittance review audits of various carrier practices and procedures for some of its universal service programs, but it does not do so for the DDTP. Although the DDTP claims it does unofficial “spot reviews” of transmittal forms to ensure accuracy, these reviews pale in comparison to a highly detailed remittance audit. No such formal review has taken place since 1997. Unchecked carrier practices and procedures create the potential for errors that would hamper the DDTP’s ability to carry out its mission.

We recommended that the CPUC rewrite its transmittal form instructions in explicit detail, ensuring consistency among carriers. In addition, the CPUC should conduct periodic remittance audits of DDTP surcharge revenues.

***CPUC Action: Partial corrective action taken.***

The CPUC stated that it engages consultants and in-house staff to conduct audits of its public programs, including financial audits of the DDTP program and audits of carriers' compliance with required surcharges. The CPUC recently utilized the hiring freeze exemption process to hire two Financial Examiners to work on some of these audits. Audit fieldwork by the Financial Examiners has been completed for four small local exchange carriers, and audit results are being reviewed and reports are being prepared. A contract with the Department of Finance (DOF) to perform audits on some larger carriers beginning early this fiscal year was approved in July 2003. The DOF will focus on a mid-sized local exchange carrier, a large inter-exchange carrier, and a large wireless carrier. The CPUC did not comment on rewriting its transmittal form instructions in more explicit detail.

**Finding #5: The DDTP does not always further the program's mission when expending public funds.**

The DDTP sometimes spends public funds on items that are unrelated to program services or that do not further the program's mission. Specifically, the DDTP has spent excessive amounts on food for training sessions, committee meetings, and other events. In addition, many program employees have DDTP credit cards, sometimes charging imprudent expenditures such as gifts and meals. Also, the DDTP has in the past reimbursed employees for expenses typically not permitted in public service, such as moving expenses and temporary rent payments. As a result, less money is available for the individuals it serves. However, the DDTP has initiated corrective action by adopting new policies on allowable expenditures.

To ensure the prudent use of public funds in furtherance of the program's mission, we recommended that the DDTP adhere to its newly revised internal control procedures that define allowable expenses.

***DDTP Action: Corrective action taken.***

Assembly Bill 1734, signed into law on June 20, 2002, authorized the CPUC to enter into contract(s) for the provision of the DDTP services. In July 2003, the Department of General Services (DGS) approved a contract between the CPUC and the California Communications Access Foundation (CCAF) to provide the personnel to operate the DDTP. As a result, the DDTP no longer exists in its previous form; rather the CCAF provides services previously provided the DDTP. The DDTP implemented a new policy specifically defining allowable and nonallowable expenses.

**Finding #6: The DDTP has not always reported taxable fringe benefits and needs additional controls to prevent personal use of vehicles.**

Previously, the DDTP failed to report to the proper taxation authorities taxable fringe benefits received by some of its employees. These benefits include paid parking and what appears to be personal use of leased vehicles. When we informed DDTP management of this, it began to initiate corrective action, including reporting parking benefits as additional income to the employee. However, the DDTP can strengthen its internal controls to prevent or record and report employees' personal use of leased vehicles.

Thus, we recommended that the DDTP develop additional procedures to prevent personal use of DDTP-leased vehicles. For example, the DDTP should label all its vehicles and require employees to maintain daily log records of miles driven. When personal use occurs, the DDTP should report it as a taxable fringe benefit to the proper taxation authorities. We also recommended that the DDTP follow its new procedures to report parking fringe benefits as taxable income on employees' W-2 forms.

***DDTP Action: Corrective action taken.***

As stated earlier, the DDTP no longer exists in its previous form; rather the CCAF provides services previously provided the DDTP. The DDTP's payroll service reported to the employee and the proper taxation authorities the taxable amount of any parking benefits per IRS rules. Also, the DDTP developed and implemented mileage logs, employees had

begun to log miles driven and locations visited on a daily basis, and supervisors verified the mileage driven. Finally, the DDTP also ordered decals for its leased vehicles, which state, "For Official Use Only," along with the DDTP logo.

**Finding #7: Some DDTP contracts lack adequate benchmarks or standards to measure contractor performance.**

Some of the contracts that we tested lacked specific performance standards for contractors as well as provisions for monetary penalties for nonperformance. The fact that the DDTP has expressed some dissatisfaction with some of the services provided exacerbates this problem. Had the DDTP established appropriate service levels, performance measures, and provisions to collect for noncompliance in the original contract, the vendors might have performed at acceptable levels or the DDTP might have collected penalties for their failure to do so.

We recommended that the DDTP ensure that all future contracts have established performance standards as well as provisions to collect damages from nonperforming contractors. Also, the program's administration will undergo some changes over the next year, including the CPUC potentially contracting out for many of the services the DDTP currently provides. Whether the CPUC contracts out for all or some of the day-to-day provision of program services, it should include specific provisions in its contracts that require contractors to comply with state laws, regulations, and policies related to reimbursable expenses. In addition, it should include specific performance standards in its contracts and monitor whether the contractors are meeting those standards. Finally, the CPUC should include provisions in its contracts that will allow it to collect damages from nonperforming contractors.

***DDTP and CPUC Action: Partial corrective action taken.***

Assembly Bill 1734, signed into law on June 20, 2002, authorized the CPUC to enter into contract(s) for the provision of the DDTP services. The CPUC reported that it conducted a competitive bidding process to contract for the personnel to operate the DDTP. The CPUC reported that its competitive bidding process and subsequent contract adhered to all required state contracting rules including requirements related to reimbursable expenses. According to

the CPUC, its contract with the CCAF includes performance measures to be met by CCAF and penalties for noncompliance. The CPUC also stated that it holds all contracts providing services or goods for the DDTP. Program contracts that existed prior to July 1, 2003, have been or are currently being transitioned to state contracts. The transition of these contracts includes submission for review and approval by DGS. The CPUC said that all future program contracts will also be submitted for DGS review and approval.



# CALIFORNIA PUBLIC UTILITIES COMMISSION

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## ***State Law and Regulations Establish Firm Deadlines for Only a Small Number of Its Proceedings***

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### *Audit Highlights . . .*

*Our review of whether the California Public Utilities Commission (commission) promptly resolves formal and informal proceedings found the following:*

- Few of the 1,602 formal proceedings the commission initiated between January 1, 2000, and June 30, 2003, were subject to statutory deadlines.*
- Commission staff provided various reasons for delays, including that the outcomes of some proceedings were dependent on other decisions or investigations or the proceedings were purposely kept open to take up related issues or to manage them in multiple phases.*
- Two factors contributed to delays in processing the more informal advice letters, which the commission uses to approve minor requests from utilities: Some had a lower workload priority and some required formal resolution or investigation.*

*continued on next page*

### REPORT NUMBER 2003-103, NOVEMBER 2003

#### California Public Utilities Commission's response as of November 2003

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits determine whether the California Public Utilities Commission (commission) promptly completes the various types of administrative proceedings it is responsible for conducting. The audit committee asked that we determine how the commission sets priorities in the water, telecommunications, and energy areas when conducting its various types of administrative proceedings. Additionally, we were asked to review staffing levels to assess whether these levels are adequate for the commission to comply with its statutory mandates regarding administrative proceedings. As part of the assessment, we were to consider other studies that may have been performed related to staffing. Finally, the audit committee requested that we identify any timelines contained in law or regulations for the completion of proceedings. We were asked to select a sample of proceedings that exceeded the timelines yet remain unresolved and another sample that exceeded the timelines but were resolved and determine the reasons for delays.

#### **Finding #1: Some proceedings the commission closed promptly that it later reopened appeared to be delayed.**

The commission resolved five of 45 proceedings we reviewed within the statutory deadline or guideline, but because its tracking system does not appropriately reflect the resolution of proceedings that are reopened, these proceedings appeared to have been delayed. The commission's system tracks numerous pieces of information about each proceeding, including the title and type of proceeding, when it was opened and closed, and when it was reopened. However, when the commission

*Although the commission cited workload and inadequate staffing as contributing to delays in processing its formal proceedings and advice letters, the lack of a workload tracking system hinders its ability to justify staffing needs.*

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reopens a proceeding, such as when it considers requests for a rehearing, and then closes the proceeding again, the later closing date replaces the initial one. Because only the later closing date is used in measuring how long the commission took to resolve the proceeding, the commission appears to have required more time than it actually did. When we became aware that the closing dates in the tracking system were not always accurate, we reviewed all 70 of the proceedings that had reopen dates and found that the commission resolved 43 within the original deadlines.

We recommended that the commission modify its tracking system to retain the original closing date as well as record its subsequent closing date for those proceedings it reopens.

***Commission Action: Pending.***

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources, but it also indicated that this aspect of the report deserved a brief comment. The commission believes that our report fails to contemplate the perhaps significant cost of either enhancing or replacing the tracking system. However, based on discussions with our information technology staff, we do not believe the cost to modify the commission's tracking system to retain the original closing date and subsequent closing date for reopened proceedings would be significant. Further, since the commission acknowledges that it does not know whether the costs to enhance or replace its tracking system would be significant, it should first determine what those costs are. If they are prohibitive, the commission should manually track the original closing dates of all proceedings it reopens.

**Finding #2: The commission did not report certain proceedings.**

Although the commission tracks and reports to the Legislature whether it has met certain deadlines established in law, it does not report whether it is meeting the 60- and 90-day deadlines for issuing draft decisions. Moreover, it does not adequately track the submission date that would allow it to do so. Specifically, although commission staff provided us with submission dates for rate-setting and quasi-legislative proceedings, two of the 12 submission dates reviewed for accuracy were erroneous. In addition, the commission initially was unable to provide us with submission dates for adjudicatory proceedings. According to

the chief administrative law judge (ALJ), the commission based its decision to report only certain deadlines to the Legislature on its belief that the Legislature is most concerned with the portion of these proceedings involving commissioners' actions; therefore, it tracks and reports whether the commissioners have met the 60-day deadline to approve final decisions. However, because ALJs are most often responsible for meeting the 60- and 90-day deadlines to prepare draft decisions, the commission's decision not to report compliance with these deadlines to the Legislature overlooks the portion of the proceedings subject to these deadlines. Therefore, because state law requires the commission to issue draft decisions within either 60 or 90 days of submission, we believe it is important to accurately track all submission dates in order to monitor compliance with these requirements.

To ensure it is complying with the 60- and 90-day deadlines between submission date and filing a draft decision, we recommended that the commission better track its submission dates and monitor whether it is meeting its deadlines.

***Commission Action: Pending.***

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources.

**Finding #3: The commission did not prepare a work plan access guide annually as required by law.**

Although state law requires that the commission develop, publish, and annually update a work plan access guide (work plan), it did not prepare the work plan for 2000 through 2002. Among other things, state law requires the commission to include within the work plan a description of the scheduled rate-making proceedings and other decisions it may consider during the calendar year, information on how the public and ratepayers can gain access to the commission's rate-making process, and information regarding the specific matters to be decided. Ultimately, the commission did prepare a work plan for 2003 that included its criteria for determining regulatory priorities and a list of the 2003 major proceedings. The commission states in its 2003 work plan that it allocates its staff resources for decision making according to a stated set of priorities established by its president.

To ensure it discloses to the public and the Legislature its process for prioritizing its proceedings, we recommended that the commission continue to annually prepare and publicize a work plan, which includes its criteria for prioritizing formal proceedings, as required by law.

***Commission Action: Corrective action taken.***

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources.

**Finding #4: The commission delayed closing or failed to close advice letters promptly.**

Staff promptly reviewed and approved 17 of the telecommunications division's and 10 of the energy division's advice letters, which the commission uses to address minor requests from utilities. However, staff either delayed closing or failed to close these 27 advice letters in the proposal and advice letter (PAL) tracking system. This represents 30 percent of the 90 advice letters we selected for testing. We believe that the high proportion of advice letters in our sample that remain open according to the dates in the PAL tracking system when they are actually closed should be of concern to the commission because it recently began using data recorded in the PAL tracking system to report to the commissioners on the status of advice letters. This type of erroneous data generated by the tracking system could be misleading to the commission and to those to which the commission reports this information.

We recommended that to ensure the information included in the PAL tracking system is accurate for reporting to the commissioners in public meetings on the timeliness of advice letters, the commission should review all advice letters in the system and close those where it is appropriate to do so.

***Commission Action: Pending.***

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources, but it also indicated that this aspect of the report deserved a brief comment. The commission believes that our report fails to contemplate the perhaps significant cost of either enhancing or replacing the PAL tracking system. However, the commission's response mischaracterized

this issue because our recommendation does not require the commission to enhance or replace the PAL tracking system, but to correct the data generated by it.

**Finding #5: The telecommunications division does not adequately maintain and track its advice letters.**

The commission's telecommunications division (telecommunications) lacks a filing system that allows it to store advice letters and the supporting documentation for the letters in a central location. Thus, telecommunications had difficulties locating advice letter files and related supporting documents. Specifically, telecommunications staff required several weeks to locate 60 advice letter files we requested and were ultimately unable to locate six of them. We observed in many instances that advice letters were located at an analyst's desk or piled on tables rather than in a central filing area. Telecommunications staff conceded that maintaining and tracking advice letters has been and continues to be a problem.

In an attempt to address its filing problems, telecommunications has initiated a pilot project that allows utilities to submit advice letters and supporting documents in an electronic format. A program manager indicated that telecommunications intends to maintain electronic copies of the advice letter and supporting documents, which he believes will facilitate their storage and tracking. Although this may eventually prove successful, telecommunications still needs to file and track the advice letters and supporting documents of utilities that currently choose not to file electronically in such a way that it is able to accurately and promptly retrieve them.

Finally, as part of its processing, telecommunications requires utilities to submit a summary sheet with their advice letters. Telecommunications uses this summary sheet to track the advice letter's progress by indicating the differing levels of review and approval it has received. However, staff often could not locate the relevant summary sheet or, when found, it was not fully completed.

We recommended that as part of its new electronic filing process, the commission ensure that the telecommunications division creates an effective centralized filing system for those advice letters and supporting documents not submitted in electronic format. Additionally, for purposes of oversight and

external and internal review, the commission should ensure that telecommunications staff consistently complete and retain summary sheets to evidence appropriate approval and review and that telecommunications maintains the summary sheets in its advice letter files.

***Commission Action: Pending.***

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources.

**Finding #6: The commission lacks a workload tracking system that would allow it to justify its staffing needs.**

Although the commission indicated that staffing is a limiting factor in promptly processing its formal proceedings and advice letters, it was unable to provide us with workload analyses to support these contentions. In fact, the Department of Finance (Finance), in various reports and management letters it prepared between February 1998 and February 2003, reported that the commission lacks a workload tracking system that would allow it to justify its staffing needs. In response to a February 2003 management letter, the commission began to revise its workload tracking system to address Finance's concerns; however, it does not anticipate implementing key phases of the new system until the end of 2003 or the beginning of 2004. Thus, during our audit the commission was unable to provide us any staffing analyses that would allow us to determine whether its staffing levels are adequate to promptly process formal proceedings and advice letters.

We recommended that the commission continue to work with Finance on improving its workload tracking system so that it can justify its staffing needs.

***Commission Action: Pending.***

The commission stated that it will implement the recommendation as best as it is able with the commission's existing resources, but it also indicated that this aspect of the report deserved a brief comment. The commission indicated that if we could not perform a quantitative analysis of the commission's staffing levels, then we might have performed some qualitative analysis. The commission further stated that we could have interviewed commission management

to see what activities or projects they believed should be undertaken but are prevented by inadequate staffing levels. Contrary to the commission's response, however, we met with the commission's management staff on several occasions. During these meetings, management staff asserted that workload and inadequate staffing contributed to delays. However, as we stated in our report, while the commission's management staff asserted they were short of staff, they could not provide evidence to support their claims.



# CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY

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## ***Insufficient Data Exists on the Number of Abandoned, Idled, or Underused Contaminated Properties, and Liability Concerns and Funding Constraints Can Impede Their Cleanup and Redevelopment***

### ***Audit Highlights . . .***

*Our review of the entities under the California Environmental Protection Agency (Cal/EPA) that oversee the cleanup of contaminated sites, the Department of Toxic Substances Control (Toxics) and the State Water Resources Control Board (State Water Board), found the following:*

- State law does not require Toxics or the State Water Board to capture information on brownfields, such as the number of sites and their potential reuses.*
- Toxics anticipates needing between \$124 million and \$146 million for the remediation of 45 existing orphan sites and \$2.4 million in fiscal year 2003–04 for orphan shares.*
- The State Water Board's unaudited data indicate that it has seven orphan sites to which it has committed \$1.4 million in state resources for cleanup.*

*continued on next page*

### **REPORT NUMBER 2002-121, JULY 2003**

**California Environmental Protection Agency, the Department of Toxic Substances Control, and the State Water Resources Control Board combined response as of October 2003**

The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct an audit of the California Environmental Protection Agency (Cal/EPA) and its entities involved in the cleanup of properties contaminated by hazardous material and waste, the Department of Toxic Substances Control (Toxics) and the State Water Resources Control Board (State Water Board). We were asked to provide information on how many orphan sites and sites with orphan shares exist in the State, as well as how much funding is needed and how much is directly available to clean up those sites.

### **Finding #1: California lacks a comprehensive inventory of brownfields.**

California does not have a uniform definition for brownfields. Further, state law does not require Toxics or the State Water Board to maintain databases to capture information on brownfields, such as the number of sites and their potential reuse. On May 30, 2003, Toxics did submit an application to the United States Environmental Protection Agency (U.S. EPA) to receive a state response grant. Toxics intends to use a portion of the grant to work with the State Water Board and the regional water quality control boards (regional water boards) to maintain and display accurate geographical information on brownfield sites and other properties that pose environmental concerns.

- ☑ *The reuse of brownfields faces challenges, such as the liability provisions the federal Superfund law imposes and limited funding opportunities.*

*Toxics and the State Water Board have yet to apply for certain federal grants available to assist with the State's assessment and cleanup costs for certain sites, such as mine-scarred lands.*

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We recommended that if Toxics does not receive funding from the U.S. EPA, Cal/EPA should seek guidance from the Legislature to determine if it desires a database to track the State's efforts to promote the reuse of properties with contamination. If the Legislature approves the development or upgrade of a statewide database that includes relevant data to identify brownfields sites and their planned and actual uses, Cal/EPA should establish a uniform brownfield definition to ensure consistency.

***Cal/EPA Action: Partial corrective action taken.***

Cal/EPA told us that Toxics was awarded funds from the U.S. EPA under the Small Business Liability Relief and Brownfields Revitalization Act. In conjunction with the award of these funds, Toxics and the State Water Board plan to continue efforts to operate and enhance their site information databases. The grant also calls for a survey and inventory of brownfields in the State. To accomplish this task, Cal/EPA will describe or define the types of properties to be included in this inventory.

**Finding #2: Existing databases do not provide a comprehensive reporting of orphan sites and sites with orphan shares.**

Toxics maintains a database to track the number of contaminated sites in the State. Although this database currently reports the number of orphan sites under its jurisdiction, the database is not able to track the number of sites with orphan shares. Additionally, due to incomplete data relating to responsible parties in the State Water Board's database, we were unable to identify the number of orphan sites under its jurisdiction. The State Water Board told us that orphan shares do not exist since the nine regional water boards apportion liability for cleanup using a strict application of joint and several liability. Under a strict application of joint and several liability there are no orphan shares because even though some share of the cleanup costs is not attributable to a responsible party, each must assume full responsibility for those costs.

We recommended that to obtain a comprehensive listing of the number of orphan sites and sites with orphan shares, the Legislature should consider requiring Cal/EPA and its entities to capture necessary data in their existing or new databases.

***Legislative Action: None.***

We are unaware of any legislative action implementing this recommendation.

**Finding #3: Toxics and the State Water Board have yet to apply for all available federal grants.**

The Small Business Liability Relief and Brownfields Revitalization Act (revitalization act) provides grants and loans to states, local governments, and other eligible participants to inventory, characterize, assess, conduct planning, and remediate brownfields. However, Toxics and the State Water Board have not applied for all available monies under the revitalization act to assist with the State's assessment and cleanup costs for certain sites.

We recommended that to reduce the State's brownfield assessment and cleanup costs, Cal/EPA should ensure that Toxics and the State Water Board apply for all available funding under the revitalization act.

***Cal/EPA Action: Pending.***

Cal/EPA stated that the U.S. EPA recently announced six workshops it plans to conduct to assist those interested in applying for grants under the revitalization act. Staff from Cal/EPA, Toxics, and the State Water Board plan to attend these workshops and will consider applying for these grant funds. Cal/EPA stated that the decision would depend upon a variety of factors, including the costs of preparing an application, costs associated with administering the grant funds, and limitations on the use of the funds.



# CALIFORNIA INTEGRATED WASTE MANAGEMENT BOARD

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## ***Its New Regulations Establish Rules for Oversight of Construction and Demolition Debris Sites, but Good Communication and Enforcement Are Also Needed to Help Prevent Threats to Public Health and Safety***

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### ***Audit Highlights . . .***

*Our review of the California Integrated Waste Management Board (board) and local agencies' oversight of solid waste facilities found:*

- The board had not finalized regulations for construction and demolition debris sites when a large fire broke out at the Archie Crippen Excavation Site (Crippen Site), which accepted construction and demolition waste in Fresno.*
- The board's interim directions did not provide the local enforcement agencies (LEAs) with clear guidance on how to handle construction and demolition debris sites.*
- Representatives of several agencies visiting the Crippen Site before the fire failed to cite and remediate conditions that ultimately made the fire difficult to suppress, raising concerns about public health.*
- The board does not track "excluded" solid waste sites because regulations do not require it to do so.*

*continued on next page*

REPORT NUMBER 2003-113, DECEMBER 2003

Responses of the California Integrated Waste Management Board, the County and the City of Fresno, and the County and the City of Sacramento as of December 2003

Each year Californians generate an estimated 66 million tons of solid waste, which must be properly handled to prevent health and environmental threats. In 1976 Congress enacted the Resource Conservation and Recovery Act of 1976, which expanded the federal government's role in regulating the disposal of solid wastes and required that all solid waste landfills comply with certain minimum criteria adopted by the U.S. Environmental Protection Agency. In that same year, when cities and counties became responsible for enforcing these standards, each local government, with the California Integrated Waste Management Board's (board) approval, designated a local enforcement agency (LEA) to enforce state minimum standards and solid waste facility permits.

Our audit concluded that, although the board has established regulations for many types of solid waste streams, it could have improved its interim guidance in its LEA Advisory #12 (advisory) for areas pending regulation. While the board was preparing regulations for construction and demolition debris waste sites, a serious fire broke out at the Archie Crippen Excavation Site (Crippen Site), which accepted construction and demolition debris, in Fresno, resulting in a threat to public health and suppression and cleanup costs of over \$6 million. Further, the board has established a system for reviewing LEAs' performance that meets statutory requirements for scope, but not for frequency.

- ☑ *The board does not complete a review of each LEA every three years, as required by law.*
  - ☑ *Through legal challenges to enforcement actions, solid waste facility operators can delay correction of identified problems.*
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**Finding #1: Until recently, the board had only an advisory statement in place of regulations for construction and demolition debris sites.**

While working on regulations for construction and demolition debris sites during the last six years, the board advised the LEAs to follow its advisory for permitting of “nontraditional” facilities, including construction and demolition debris waste sites. The advisory’s purpose is to guide LEAs and board staff on the permitting of nontraditional facilities with activities not yet covered by regulations. “Nontraditional facilities” are those facilities other than landfills, transfer stations, and composting facilities that handle or process solid waste. Although not precluding LEAs from accepting applications for solid waste facility permits at these sites, the advisory strongly encourages LEAs not to accept applications for solid waste facility permits for materials and handling methods that are under evaluation. However, the advisory also states that should an LEA consider a facility proposal that appears to fall into the nontraditional facility category, but not be certain whether the advisory’s interim policy applies to the particular facility, the LEA can contact the board’s permitting branch representative for assistance.

In August 2003, after many draft proposals and public comments, the first phase of the regulations became effective, covering the transfer and processing of construction and demolition debris. At that time, work was also progressing on the second phase, dealing with the disposal of construction and demolition debris. The board has indicated it adopted regulations for construction and demolition debris disposal in September 2003, and they are scheduled to become effective in January 2004.

We recommended that to meet the goals of the California Integrated Waste Management Act of 1989 (Waste Act) and improve regulation of solid waste, the board should complete and implement as promptly as possible its work on the second phase of regulations for construction and demolition debris sites, covering the disposal of the waste materials.

***Board Action: Partial corrective action taken.***

The board stated that on September 17, 2003, it adopted the second phase of regulations for construction and demolition debris sites. In addition, on November 10, 2003, the regulations were submitted to the Office of Administrative Law (OAL) for approval. OAL’s 30 working day review period

ended on December 26, 2003. The regulations will become effective soon after approval by OAL and filing with the Secretary of State.

**Finding #2: Concerns about the Crippen Site were not addressed.**

In the two years before the Crippen Site fire, staff of the city of Fresno Code Enforcement Division, the city of Fresno Fire Department, the Fresno LEA, and the board visited the site. According to the city of Fresno's Planning Commission resolution to revoke the Crippen Site's conditional use permit after the fire, the Crippen Site had accumulated material in type and quantity that violated the terms of the conditional use permit, and the debris pile had existed for at least seven years before the fire. Thus, staff of each of these agencies observed the conditions at the Crippen Site. However, because of questions about the board's written direction in its advisory and verbal directions to the LEA at the time of the board staff's visit to the Crippen site, lack of communication between some of these agencies, and failure to cite the conditions, the problems at the Crippen Site were not remediated.

We recommended that to ensure sites are adequately monitored, the board should clarify the intent of the advisory for currently known or newly identified nontraditional sites for which regulations are not yet in place. For example, the board should resolve the ambiguity between the advisory's statement that LEAs are strongly encouraged not to accept applications for solid waste facility permits for materials and handling methods under evaluation, on the one hand, and its statement that it is ultimately the responsibility of the LEAs to determine whether to require solid waste facility permits for such sites, on the other hand. In addition, when it determines that an LEA has inappropriately classified a site—for example, treating a composting site as a construction and demolition debris site—the board should work with the LEA to correct the classification.

***Board Action: Pending.***

The board has stated that subsequent to the adoption of Phase II of the Construction and Demolition Debris and Inert Debris regulations, board staff determined that the advisory no longer provided needed guidance and therefore suspended it. Further, the board stated that it will continue to assist LEAs in placing solid waste handling activities,

including ones handling new or unique waste streams, within the appropriate tier of the regulatory framework. In addition, the board stated that this assistance will continue to include periodic training on the regulations, solid waste facility type definitions, and tier permit requirements, as well as ongoing technical support through direct contact with board staff and through the board's Web site.

**Finding #3: Questions arose about the city of Fresno's handling of the Crippen Site fire.**

During a hearing of a Senate select committee on air quality in the Central Valley, questions arose about the city of Fresno's preparedness for the Crippen Site fire, its fire-fighting techniques, and its timing of requests for expert assistance. In April 2003 a city of Fresno task force made up of concerned citizens, representatives of various interest groups, city and county officials and staff, and current and former members of the City Council issued its report on the events associated with the Crippen Site fire and made 24 recommendations for addressing identified problems. Areas the recommendations covered included, but were not limited to, issuing of permits, monitoring sites with conditional use permits, setting staffing levels and providing training, determining the adequacy of policies and procedures for code enforcement, establishing adequate means for communicating warnings about health hazards, and assessing the adequacy of the emergency response plan. As of late October 2003 the city's status report on its implementation of the recommendations indicated that only seven recommendations remained outstanding.

We recommended that to ensure it appropriately permits, monitors, and enforces compliance with the terms of its conditional use permits and has an adequate system in place to deal with emergencies, such as the Crippen Site fire, the city of Fresno should continue to implement the remaining recommendations from its task force report on the response to the Crippen Site fire. In particular, it should ensure the proper training of staff to ensure they identify existing problems at sites with conditional use permits and effectively enforce compliance with regulations and the terms of conditional use permits, and Code Enforcement should continue implementing its proactive, risk-based monitoring of conditional use permits. It should also take steps to ensure its response to emergencies is effective and prompt.

*City of Fresno Action: Partial corrective action taken.*

As of November 25, 2003, the city of Fresno reported that it had implemented 21 of the 24 recommendations and expected to implement the remaining three by January 2004.

**Finding #4: New regulations address the lack of oversight of construction and demolition debris sites, but certain operations still lack adequate regulation.**

The board's new requirements for processing construction and demolition debris now provide regulatory guidance for oversight of facilities and operations. However, some construction and demolition operations and facilities may fit into the excluded tier of the board's regulatory system. The board's regulations do not require operators in the excluded tier to notify the LEA of their intent to operate, and such operators who increase their activity enough to require a permit are merely "honor bound" to notify the LEA of any changes that modify their current operations. If the LEA is not aware that an excluded tier activity is taking place, the LEA is unable to monitor the activity. Relying on operators to self-report or the industry to self-monitor is insufficient to ensure that all excluded tier activities are accounted for, tracked, and monitored to ensure that materials on site are stable and will not harm public health and safety.

Regulations specify that the LEA or the board can inspect an excluded tier activity to verify that the activity continues to qualify as an excluded tier activity and can take any appropriate enforcement action. However, our survey of LEAs indicated that 26 of 48 responding LEAs, including the two LEAs we reviewed, monitor excluded tier activities only by responding to complaints or reports from other entities. None of these LEAs stated that it performs periodic on-site visits or inspections outside of receiving a complaint.

Of the 48 LEAs responding to our survey, 43 told us that they track the existence of excluded tier activities when they are notified that a local government is considering a conditional use permit or when another entity or department files a complaint with the LEA. However, regulations do not require this tracking, and our visit to one LEA identified that after initially confirming that an activity falls in the excluded tier, the LEA does not track or perform any further monitoring of that activity to determine whether the operator has maintained or changed its activity

level. Also, local governments may not forward all conditional use permits to their LEAs for review, so some operations may remain unknown to the LEAs.

We recommended that to ensure the enforcement community is aware of excluded operations that could potentially grow into a public health, safety, or environmental concern, the board should require, pursuant to the Public Resources Code, Section 43209(c), LEAs to compile and track information on operations in the excluded tier. To track this information, each LEA should work with its related cities and counties to develop a system to communicate information to the LEA about existing and proposed operations in the excluded tier with the potential to grow and cause problems for public health, safety, and the environment. For example, cities and counties might forward to LEAs information about requests for conditional use permits, revisions to current conditional use permits, or requests for new business licenses. We are not suggesting that the LEA track all operations in the excluded tier—for example, backyard composting or disposal bins located at construction sites. In addition, the board should require LEAs to periodically monitor operations in the excluded tier to ensure that they still meet the requirements for this tier. Finally, in its triennial assessments of each LEA, the board should review the LEA's compliance with these requirements regarding excluded sites.

***Board and the Counties of Fresno and Sacramento Actions: Pending.***

The board stated that it placed operations into the excluded tier through rulemaking pursuant to the Administrative Procedures Act, which includes full participation by stakeholders and potentially affected parties. In addition, the board stated that the placement is based on professional, technical, and scientific analysis. Further, the board stated that it defines these excluded activities so that there is regulatory certainty that they do not require permits. Nevertheless, the board stated that LEAs are still responsible for being aware of changes in activities located in their jurisdiction. The board agreed that there may be some value in encouraging LEAs, in concert with other local regulatory requirements, to develop mechanisms for identifying and tracking activities that may trigger additional regulatory requirements.

Although the county of Fresno responded to the audit report, its responses did not specifically address this recommendation.

The county of Sacramento stated that the management of Solid Waste in local jurisdictions is most often carried out, through State delegation, by counties and cities. Funding of programs is an area that is a significant consideration, and it is problematic to charge fees to businesses that are exempt or in categories that may not require inspection or regulation.

**Finding #5: Board evaluations are substantially appropriate in scope, but do not meet the three-year mandate.**

Our review of five LEA evaluations the board completed found that the established scope of the evaluation is appropriate and that the board complied with that scope. The evaluation covers all six specific areas of interest identified in regulations and further ensures that the LEAs continue to comply with certification requirements. However, the board is not timely with its LEA evaluations, beginning or scheduling evaluations to begin on average about 11 months after the end of the mandated three-year cycle. However, the board's definition of what represents a three-year cycle increases the problem. The board defines the three-year cycle as beginning at the conclusion of the LEA's last evaluation and ending at the date the next evaluation is initiated. Our interpretation of the statutory requirement, however, is that LEA performance evaluations should be completed every three years or more frequently. Thus, if an evaluation is completed on February 1, 2001, the next should be completed no later than February 1, 2004. The board's approach, when combined with the time required to actually conduct an evaluation and develop a workplan, if necessary, may delay the discovery and resolution of potential performance shortcomings in an LEA.

We recommended that to comply with existing law, the board should complete evaluations of LEAs within the three-year cycle. If that is not feasible, the board should propose a change in law that would allow a prioritization system to ensure that it at least evaluates LEAs with a history of problems every three years.

***Board Action: Pending.***

The board has stated that staff believes the third cycle of LEA evaluations can be completed within the three-year cycle, partly because of the experience it has gained during the last two cycles. In addition, the board stated that its staff constantly re-examines its internal practices and will continue to work on methods to streamline the evaluation

process, such as firmer deadlines for internal fact-finding and report review. The board also stated that it will consider our suggestions as it reviews the recommendation.

**Finding #6: Legal challenges can significantly delay correction of identified problems at noncomplying solid waste sites.**

Even if all regulations were in place, all monitoring occurred promptly, and enforcement actions were initiated promptly, identified problems would not necessarily be corrected immediately. The process to correct violations can be lengthy, and it may involve hearings and legal proceedings, including appeals of decisions in each. The Waste Act contains a comprehensive enforcement scheme for solid waste facilities, designed to allow LEAs to bring various enforcement actions against owners and operators for violations of the Waste Act. Under certain circumstances, the board may take enforcement actions itself. This enforcement scheme includes the ability to issue a corrective action order or a cease and desist order, to administratively impose civil penalties, and to suspend or revoke a permit under certain conditions. However, this enforcement scheme allows a person who is the subject of any of these enforcement actions to request a hearing before a local hearing panel, which must be established pursuant to the requirements and procedures delineated in Public Resources Code, and then before the board. If a hearing is requested, the enforcement order is “stayed,” or rendered inoperative, until all appeals to the local hearing panel and the board have been exhausted or the time for filing an appeal has expired, unless the LEA can make a finding that the activity constitutes an imminent threat to the public health and safety or environment. Consequently, a person who is the subject of an LEA enforcement order can continue the activity that is the subject of the order until all appeals have been exhausted.

We recommended that the Legislature may wish to consider amending the current provisions of the Waste Act that allow a stay of an enforcement order upon the request for a hearing, and to streamline or otherwise modify the appeal process to make it more effective and timely and enhance the ability to enforce the Waste Act.

***Legislative Action: None.***

We are not aware of any action taken by the Legislature regarding the Waste Act.

***Board and the Counties of Fresno and Sacramento Actions: Pending.***

The board stated that it may be time to re-examine the effectiveness of this provision. In addition, board staff agrees that this issue warrants further consideration.

Although the county of Fresno responded to the audit report, their responses did not specifically address this recommendation.

The city of Sacramento stated that local jurisdictions use a proactive approach utilizing education, audit (inspection), and enforcement in ensuring compliance with applicable laws and regulations. The current mandated process for solid waste enforcement is particularly cumbersome, protracted, and costly. The city of Sacramento further stated that the Legislature, CalEPA, and the board should consider allowing or mandating an enforcement process more consistent with other successful processes in the State and local environmental regulatory programs.



# STATE OF CALIFORNIA

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## ***Its Containment of Drug Costs and Management of Medications for Adult Inmates Continue to Require Significant Improvements***

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### **Audit Highlights . . .**

*Our review of the State's drug and medical supply procurement practices reveals:*

- Annual expenditures for the five agencies most frequently purchasing drugs increased by an average of 34 percent per year between fiscal years 1996–97 and 2000–01.*
- The Department of General Services has explored a variety of options, but it has not gone far enough in improving the State's drug procurement process. Moreover, the State needs a statewide process for contracting for medical supplies.*
- The Department of Corrections' (Corrections) Health Care Services Division continues to have significant weaknesses that prevent it from effectively monitoring its pharmacies' purchases of drugs, such as:*
  - *As of November 2001 it had not updated its formulary nor monitored compliance with the existing one.*
  - *It lacks a utilization management program that can assist in reducing costs.*

### **REPORT NUMBER 2001-012, JANUARY 2002**

**Department of General Services' response as of January 2003 and Department of Corrections' response as of December 2002**

Chapter 127, Statutes of 2000, required the Bureau of State Audits (bureau) to report to the Legislature on the trends in state costs for the procurement of drugs and medical supplies for offenders in state custody and to assess the major factors affecting those trends. The statutes also required the bureau to summarize the steps that the Department of Corrections (Corrections), the Department of General Services (General Services), and other appropriate state agencies have taken to improve drug and medical supply procurement and to comply with prior bureau recommendations relating to necessary reforms to improve the procurement of drugs.

In fiscal year 1996–97 state agencies purchased \$41.6 million in drugs, but in fiscal year 2000–01 their purchases rose to \$135.1 million, which represents an annual average increase of 34.3 percent for this five-year period. During the same period state agencies' expenditures for medical supplies rose from \$11.1 million to \$14.2 million, which represents roughly a 27 percent increase.

Restrictions in state and federal law prevent human immunodeficiency virus-positive inmates in federal and state prisons, such as Corrections', from benefiting from the State's AIDS Drug Assistance Program. Further, Corrections may not use the federal supply schedule, which by federal law places limits on the prices of drugs that the federal Department of Veterans Affairs, the Department of Defense, the Public Health Service, and the Coast Guard purchase because it is not affiliated with one of these eligible federal agencies.

However, we found that General Services and other state agencies such as Corrections could do more to control the State's drug and medical supply expenditures. Specifically, we found:

- Its pharmacy staff do not regularly review monthly reports to understand if purchases are cost-effective.
- Its pharmacy prescription tracking system cannot support monitoring, cost-containment efforts, or day-to-day management of pharmacy services.
- Corrections does not plan to replace this system until November 2006, and development of the new system is already behind schedule.
- Finally, we found that Corrections is not eligible for some options, such as the AIDS Drug Assistance Program and the federal supply schedule.

**Finding #1: General Services needs to do more to identify the best option for reducing drug costs.**

General Services has not been successful in securing more individual contracts with drug manufacturers for more drugs at less-than-wholesale acquisition cost, the standard price a wholesaler pays a manufacturer for drug products not including special deals, such as rebates or discounts. Further, General Services recently contracted with the Massachusetts Alliance for State Pharmaceutical Buying but failed to fully analyze other options, such as contracting with Minnesota Multistate Contracting Alliance for Pharmacy (MMCAP) or directly with a group-purchasing organization, before doing so. This action may have prevented the State from achieving greater future savings.

General Services should increase efforts to solicit bids from drug manufacturers so that it can obtain more drug prices on contract. Further, General Services should fully analyze measures to improve its procurement process, such as joining MMCAP or contracting directly with a group-purchasing organization.

***General Services' Action: Partial corrective action taken.***

General Services reported that it has awarded two-year contracts covering 321 line items, primarily generic drugs, which went into effect on November 1, 2002. Further, based on analysis of the bids it received, General Services identified an additional 140 drug line items for inclusion in its contract with the Massachusetts Alliance for State Pharmaceutical Buying (Massachusetts Alliance). In January 2003 General Services received statutory authority to enter into contracts

in a bid or negotiated basis with manufacturers and suppliers of single-source or multi-source drugs, which it believes allows it to explore additional strategies for managing drug costs.

General Services also reported that it was conducting a detailed review of the effectiveness of using the Massachusetts Alliance. General Services stated that as part of its review it surveyed a number of group-purchasing organizations and compared the advantages of using other group-purchasing organizations with its current relationship with the Massachusetts Alliance. General Services told us that its current agreement produced the greatest savings, which it estimated at roughly \$5.9 million annually. General Services stated that it is committed to continually evaluating other approaches and is working with MMCAP to analyze drug procurement data.

**Finding #2: Although General Services is spearheading efforts to develop a statewide drug formulary, it has not ensured that state agencies will be able to enforce the formulary.**

A drug formulary is a listing of drugs and other information representing the clinical judgment of physicians, pharmacists, and other experts in the diagnosis and treatment of specific conditions. One of the main purposes of a formulary is to create competition among manufacturers of similar drugs when the clinical uses are roughly equal. The success of a statewide formulary and the State's ability to create enough competition to negotiate lower drug prices for certain products depend on how well state agencies adhere to the statewide formulary when they prescribe drugs. Currently, Corrections, which was responsible for roughly 68 percent of the State's drug purchases in fiscal year 2000–01, has an outdated formulary and lacks sufficient data to perform reviews that can identify prescribing patterns. Agencies that help develop but do not adhere to strict guidelines for enforcing the formulary would negate the State's effort.

Therefore, General Services should fully consider, and attempt to mitigate, all obstacles that could prevent the successful development of a statewide formulary.

***General Services' Action: Partial corrective action taken.***

General Services has formed a Pharmacy Advisory Board (board) to assist in its implementation and administration of a statewide pharmaceutical and medical supply program. The board held one meeting in September 2002 and plans to hold its next meeting in early 2003. General Services' Common Drug Formulary Committee, which is a subcommittee of the board, has received approval to begin contract negotiations for a number of proprietary drugs that were recommended for inclusion on the State's common drug formulary listing.

**Finding #3: The State lacks statewide agreements for purchasing medical supplies.**

Often state agencies are not aware of what their institutions are purchasing and how much they are paying for medical supplies. Typically, each state agency or individual institution generally procures its own medical supplies. Currently, General Services has only two medical supply contracts and is unaware of what medical supplies the agencies use and what they pay for them. However, it believes that having a medical supply catalog would aid state agencies in obtaining these supplies.

General Services should ask state agencies to determine their needs and then consider contracting for a medical supply catalog to maximize the State's buying power.

***General Services' Action: Partial corrective action taken.***

General Services has formed a Medical and Surgical Supply subcommittee to focus on the needs of state and local government entities. General Services reported that it is developing a request for proposal for the medical and surgical supply program, which it expects to release in early 2003.

**Finding #4: Corrections' Health Care Services Division (Health Care Services) lacks an effective system for controlling drug purchases.**

Despite the recommendation in our January 2000 report to update its departmental formulary and use it to control which drugs medical professionals can prescribe routinely, as of November 2001, Corrections' Health Care Services still had not done so. Further, Health Care Services does not monitor its pharmacies' noncontract purchases from the

State's prime vendor and cannot substantiate the reasons they are choosing to purchase potentially more expensive noncontract drugs. Until Health Care Services addresses significant deficiencies, neither an external or internal pharmacy benefits manager can accomplish the task of improving its contracting and procurement for drugs.

As we previously recommended, Health Care Services should update its formulary and ensure that headquarters and prison staff monitor compliance with the formulary. Further, Corrections should ensure that prisons receive monthly contract compliance reports from the prime vendor and use them to monitor noncontract purchases. Finally, Corrections should await the results of its consultant's report and identify those recommendations that will be beneficial to the program. Only then should it decide whether to hire an internal or external pharmacy manager to assist in resolving its pharmacy operations deficiencies.

***Corrections' Action: Partial corrective action taken.***

Corrections reported that it had revised its formulary and planned to distribute it in early 2003. It also plans to hold trainings on this formulary and on the use of reports it receives from the prime vendor to monitor noncontract purchases. Corrections also reported that it received its consultant's report and identified the recommendations beneficial to the pharmacy program, such as the creation of a Pharmacy Services Unit at its headquarters. However, although it has identified the resources necessary to implement the recommendations, Corrections reported that it is still in the process of filling the position of pharmacy services manager for that unit.

**Finding #5: Health Care Services did not always meet criteria for using mail-order pharmacy services.**

Although Corrections obtained approval from General Services to use mail-order pharmacy services in prisons when pharmacist vacancy rates rise to more than 50 percent, it did not demonstrate that the use of mail-order pharmacy services was necessary. Specifically, we cannot substantiate Corrections' shortage of pharmacists and thus its need for mail-order pharmacy services because Health Care Services lacks sufficient information about its use of registry employees. A registry service provides

pharmacists who can fill in for long- or short-term staffing needs resulting from vacancies, illnesses, or exceptional workload conditions.

Further, Corrections still has not addressed our previous recommendation that it consider whether it has appropriately divided responsibilities between its pharmacists and pharmacy technicians. This analysis could indicate that Corrections may be able to allow pharmacy technicians to assume more responsibilities so that it can lower the number of pharmacists necessary to run its pharmacies.

Corrections should take the necessary steps to substantiate its position that a shortage of pharmacists exists. Additionally, it should analyze whether it has the appropriate division of responsibilities between its pharmacists and pharmacy technicians. If it is able to substantiate that a pharmacy shortage exists and General Services approves another contract for mail-order pharmacy services, Health Care Services should ensure that prisons meet the contract conditions before beginning to use these services and monthly thereafter.

***Corrections' Action: Partial corrective action taken.***

Corrections reported that it has gathered and reviewed data related to pharmacists, pharmacy technicians, the number of satellite pharmacies, and its use of registry pharmacists to evaluate the extent of a pharmacist shortage. However, Corrections told us that it is unable to determine the appropriateness of the staffing ratios until it decides on which consultant recommendations it will implement.

**Finding #6: Although its prescription tracking system is inadequate, Corrections has made little progress in implementing a new system.**

Corrections has been trying to replace its prescription tracking system and other health care information technology systems since 1991 without significant progress. Currently, it is behind schedule on its plans to implement a new health care management system by November 2006 as part of its Strategic Offender Management System and is not considering an automated pharmacy system in the interim.

Corrections should accelerate the acquisition and implementation of the Strategic Offender Management System and its new health care management component.

***Corrections' Action: Partial corrective action taken.***

Corrections reported that its implementation of the new system depends on infrastructure and resources. However, Corrections also reported that it has completed a feasibility study report, as an interim solution, to procure an existing pharmacy management software package for its local institutions and headquarters. Corrections told us that the report is being reviewed by the Department of Finance.

**Finding #7: Corrections made significant errors in attempting to streamline its drug dispensing process.**

Corrections neither sought the necessary approvals to contract with the vendor of an automated drug delivery system nor ensured that it uses the system in accordance with state law. The California State Prison, Sacramento's, entering a limited-time agreement to obtain two machines for \$4,999.99 appears to be a circumvention of the State's requirement of securing at least three competitive bids for each contract of \$5,000 or more.

Corrections also failed to consider thoroughly the legal ramifications of using an automated drug delivery system. To control misuse, state law allows the removal of drugs from these machines in only one of three circumstances: (1) to provide drugs for a new prescription order, (2) to provide drugs in an emergency, or (3) to provide drugs that the medical practitioner has prescribed for an inmate to take as the need arises. Corrections contends that it is using the system appropriately, since the law pertains only to skilled nursing or intermediate care facilities. However, our attorney's analysis of the law is that Corrections' authority to use these machines in health care facilities in its prisons is unclear. Specifically, although the legislative history of Senate Bill 1606 indicates that the Legislature had skilled nursing and intermediate care facilities in mind when drafting it, the state law setting forth the circumstances in which automated drug delivery machines may be used refers to "facilities" in a generic sense and not merely skilled nursing and intermediate care facilities.

Corrections should cease using its automated drug delivery system until it secures a contract in accordance with the State's public contracting laws. Further, Corrections should seek an opinion from the attorney general to support its current use of the machines.

***Corrections' Action: Partial corrective action taken.***

Corrections reported that it received approval on a contract for the automated drug delivery machines on December 24, 2001. However, Corrections has chosen not to seek an opinion from the attorney general because it does not believe that Health and Safety Code, sections 1261.5 and 1261.6, apply to its pharmacies.

# DEPARTMENT OF HEALTH SERVICES

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## ***It Needs to Significantly Improve Its Management of the Medi-Cal Provider Enrollment Process***

REPORT NUMBER 2001-129, MAY 2002

Department of Health Services' response as of April 2003

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### ***Audit Highlights . . .***

***Our review of the Department of Health Services' Provider Enrollment Branch's management of the Medi-Cal provider enrollment process revealed that:***

- It lacks reliable data to determine the size of its backlog.***
  - It could not substantiate its decisions to designate certain providers as being at high risk for fraud.***
  - It did not always review disclosure statements required by the federal Health and Human Services Agency, aimed at identifying applicants with a history of defrauding or abusing the Medicaid system.***
  - It will continue to have difficulty effectively managing its operations until it develops a strategic plan and fully implements its data tracking system.***
- 

The state Department of Health Services (department) administers California's Medicaid program, referred to as Medi-Cal, which accounts for almost \$27 billion in annual expenditures. A provider must obtain a valid Medi-Cal provider number in order to bill the Medi-Cal program for services provided to an eligible Medi-Cal beneficiary. The department's Provider Enrollment Branch (branch) is responsible for reviewing applications for providers such as physicians, physician groups, pharmacies, and clinical laboratories. The branch received more than 27,000 applications between February 14, 2001, and January 31, 2002.

The Joint Legislative Audit Committee requested that we examine the process used by the department for enrolling Medi-Cal providers. Our audit concluded that until the branch addresses certain deficiencies, it would continue to have difficulty meeting its regulatory timelines, securing additional staff, and effectively managing its operations. Specifically:

### **Finding #1: The branch cannot determine the number of applications remaining to be processed.**

The branch does not know how many of the roughly 27,000 applications it received between February 14, 2001, and January 31, 2002, have been approved, denied, or remain to be processed. In February 2001, the branch instituted a new database—the Provider Enrollment Tracking System (PETS)—which can provide such information. However, branch management is unable to use PETS to provide management reports that will allow it to determine the number of applications awaiting final disposition because staff have not always entered data into the database consistently. Although

the branch had devoted time and resources to develop PETS and train staff, we found no evidence that the branch has implemented a procedure to review periodically the data that staff input into PETS. Because staff do not enter data into PETS consistently, the branch can neither effectively track the applications it processes nor use the reports PETS is capable of producing to identify its backlog and manage its operations.

We recommended that to improve the management of the Medi-Cal provider enrollment process, the branch should use PETS more effectively to track how long an application has been in a certain step of the enrollment process, making sure that notification is sent to the applicant at proper intervals; and modify PETS so it can track the status of high- or low-risk provider types and determine whether the average processing times vary. The branch also should identify all applications that, according to PETS, are still in progress, determine their actual status, and update PETS, if necessary. Further, the branch should review PETS-generated reports at least monthly and perform analyses to determine whether staff are entering data accurately and consistently. Finally, it should fully use the capabilities of PETS for developing reports on a variety of productivity indicators, including, for example, aging reports and reports showing the number of applications approved, denied, and in progress.

***Department Action: Corrective action taken.***

In its one-year response dated April 23, 2003, the department stated that PETS is now used to determine the length of time an application is in progress, track the status of high- and low-risk provider types, and determine the average processing time for both. Additionally, in order to conform to the timeframes required by the enrollment regulations, PETS now generates several reports for department staff to use to track the progress and status of pending applications. Further, PETS has been modified to allow staff to track those applications that are resubmitted within 35 days, because when initially submitted the applications were not complete.

At the end of December 2002, the department completed the establishment of additional edits in the PETS database to ensure data entered is valid. The branch will continue to monitor and review reports produced by PETS and add edits to meet program report needs as required.

**Finding #2: The branch does not ensure that it reviews applications within 180 days.**

Although PETS cannot provide meaningful information for those applications that are pending branch action, it does show that the branch frequently took more than 180 days to process some applications. We found that the data was reliable when branch staff entered both the receipt and completion date. In addition to not consistently tracking the applications it processes internally, the branch also does not monitor applications it refers to the department's Audits and Investigations (A&I) unit for on-site reviews. The branch does not use PETS to establish or track dates indicating when it should receive a response back from A&I so that it can meet its regulatory deadlines.

We recommended that to improve its monitoring of referrals, the branch should use PETS to track applications it refers to A&I. Also, the branch should work closely with A&I to monitor the status of its referrals to ensure that the total review time for applications does not exceed regulatory requirements. In addition, the department should establish policies and procedures for the branch and A&I to coordinate their review processes so it is able to meet regulatory requirements and ensure that A&I implements its new case-tracking system by late 2002.

***Department Action: Corrective action taken.***

The department reported that, in addition to having the data in PETS, the branch entered all of its referrals directly into A&I case-tracking system, which was implemented in October 2002. The department also stated that branch staff have been trained to use the system and have direct access to check the status of pending referrals.

**Finding #3: The branch could not substantiate its decisions to designate certain providers as high- or low-risk.**

The branch's objective is to prevent providers with fraudulent intent from participating in the Medi-Cal program. Consequently, it is reasonable that the branch should use relevant and available information to identify those provider types that pose a greater risk of fraud. Further, the branch should document these decisions and review them periodically to ensure that they are still relevant. However, the branch could not substantiate how it determines the risk that it assigns to certain provider types, nor does it reevaluate its risk assessment periodically.

We recommended that the branch periodically perform an analysis to justify its existing risk assessments for high- and low-risk provider types and submit its analysis for department approval. Upon approval of the analysis, the branch should issue a policy memo to staff. Further, the department should formalize its process for determining which provider types should be subject to increased scrutiny and when, based upon the most recent anti-fraud trend information available.

***Department Action: Partial corrective action taken.***

The department stated that informally it continually evaluates risk assessments for effectiveness and applicability. The department told us that it will continue to work with its partners to identify and evaluate risk indicators and trends. If any significant changes in current assessments of high- and low-risk providers are proposed, formal documentation will occur. Also, A&I and the branch have established monthly meetings with the first meeting occurring in December 2002, to address anti-fraud issues and to review all provider types that need closer scrutiny.

**Finding #4: The branch needs to rectify its poor decision to cease reviewing certain provider disclosure statements, which exposes the State to loss of federal funds.**

Although both state and federal regulations require applicants or providers to submit disclosure statements with their applications, in its effort to reduce its backlog, the branch inappropriately stopped reviewing disclosure statements for certain applicants or providers. Specifically, the branch did not review all disclosure statements received between October 2000 and September 2001 for physician and allied group applicants or providers. As a result, the branch increased the risk of enrolling providers who may have disclosed questionable financial relationships or a past history of fraud, abuse, or criminal convictions relating to other Medicare or Medicaid programs.

We recommended that the branch identify all physician providers who were enrolled between October 2000 and September 2001 and review their disclosure statements in accordance with federal requirements. The branch should direct staff to continue to review disclosure statements for all providers.

***Department Action: Partial corrective action taken.***

The department reported that it plans to implement this recommendation on a flow basis. Specifically, as the branch receives requests or inquiries from providers who enrolled between October 2000 and September 2001, staff will review the initial application. If the initial application does not include a disclosure statement, one will be requested and reviewed.

**Finding #5: Reenrollment of existing providers could strengthen the Medi-Cal enrollment process.**

To strengthen the enrollment process and weed out potentially fraudulent providers, the branch should expand its efforts to reenroll existing providers. In August 1999, the department began to reenroll certain provider types identified as problematic. The branch is continuing its efforts to reenroll durable medical equipment and non-emergency medical transportation providers. However, due to the increase in workload resulting from its reenrollment efforts, the branch has postponed its reenrollment of independent pharmacies until summer 2002.

We recommended that the branch complete its current reenrollment efforts and consider expanding these efforts to include all provider types to ensure provider integrity in the Medi-Cal program.

***Department Action: Partial corrective action taken.***

The department told us that its reenrollment efforts for durable medical equipment, orthotics and prosthetics, and non-emergency medical transportation providers is substantially complete. The department received approval to create a reenrollment section in fiscal year 2002–03. Initial mailings to reenroll pharmacy and physician providers were sent in February 2003 and as of March 2003 the branch had notified approximately 1,000 of these providers and was awaiting either responses or application packages.

**Finding #6: A strategic plan would help the branch address its performance deficiencies.**

The branch has addressed only a few of the essential elements of strategic planning such as defining its mission and establishing its top priorities. However, the branch has not described the

actions necessary to achieve its top priorities. For example, the branch states that it will reduce the backlog of physician applications, but does not address critical questions relevant to doing so, such as how it will determine the number of applications in progress and whether it has sufficient staff.

We recommended that the branch develop a strategic plan to identify key responsibilities and establish priorities. This plan should clearly describe how the organization would address its many short- and long-term responsibilities, particularly those that we observed it has not sufficiently accomplished. In addition, the branch should conduct a study to determine how long it takes staff, on average, to process applications for the various provider types. Using results from the study and accurate workload standards, the branch should assess whether it has the appropriate staffing levels.

***Branch Action: Corrective action taken.***

The branch reports that it has developed a strategic plan, which is currently in place.

**Finding #7: The department did not adhere to state hiring practices in its efforts to seek additional resources for the branch.**

Although state laws establish the standards to use in contracting for personal services, the department did not follow these standards when attempting to secure employees to assist the branch with processing provider enrollment applications. Specifically, the department had not obtained approval to use up to 10 contractor staff to assist the branch during the period of July 2001 through January 2002, but had incurred costs of roughly \$490,000. Also, the department may not have met the State's standards for using personal services contracts when it hired student assistants through contracts with the California State University Sacramento Foundation (foundation). Between March 1, 2001, and January 31, 2002, the branch incurred costs of more than \$138,000 in salaries, employment taxes, and fees to reimburse the foundation for the 22 student assistants it hired. However, the department did not prepare an analysis to demonstrate that contracting with the foundation could result in actual overall cost savings to the State.

We recommended that the department should discontinue its use of contractor staff to assist the branch in processing provider enrollment applications. It should also ensure that it adheres to state standards for using personal services contracts when hiring employees such as student assistants.

***Department Action: Corrective action taken.***

The department stated it discontinued its use of contractor staff effective May 31, 2002. Further, the department contends that it does adhere to state standards for using personal service contracts when hiring employees such as student assistants and will continue to do so.



# DEPARTMENT OF MANAGED HEALTH CARE

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## ***Assessments for Specialized and Full-Service HMOs Do Not Reflect Its Workload and Have Disparate Financial Impacts***

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### ***Audit Highlights . . .***

*Our review of the assessment structure of the Department of Managed Health Care found that:*

- The portion of assessments charged to specialized health maintenance organizations (HMOs), at 48 percent, exceeds the 22 percent of identifiable workload attributable to specialized HMOs.*
- The current assessment structure results in disparate financial impacts with specialized HMOs charged about nine times more per dollar of premiums than full-service HMOs.*
- Alternative methods could better align assessments with workload and reduce disparities in financial impact.*

*In addition, our review of six core operating units found that:*

- Four units are meeting deadlines and/or have greatly expanded services.*
- Two units, Financial Oversight and Licensing, are often late issuing financial examination reports and sending written notifications to HMOs regarding material changes in health care plans.*

REPORT NUMBER 2001-126, MAY 2002

Department of Managed Health Care's response as of May 2003

The Joint Legislative Audit Committee requested that we review the assessment mechanism used to generate funds for the Department of Managed Health Care (department) to determine whether the assessments paid by different classes of health maintenance organizations (HMOs) reflect the level of regulatory activity related to them. It also asked us to propose alternative assessment structures, if necessary, that would more closely reflect the level of regulatory costs and ensure adequate funding to meet the department's statutory responsibilities.

### **Finding #1: The annual assessments paid by two classes of HMOs—specialized and full-service—are not distributed equitably.**

The percentage of the total assessment that the department charges to specialized and full-service HMOs does not match the level of effort the department devotes to these two classes of HMOs. Although assessments for specialized HMOs amount to 48 percent of total assessments, only 22 percent of the department's work that is identifiable by HMO class is attributable to them.

In addition, the financial impact of the assessment on HMOs, as represented by the percentage of their premiums that the HMOs are charged for assessments, varied widely between the different classes of HMOs. Specifically, the assessments the department billed to full-service HMOs amounted to about 0.04 percent of their premiums on average, while those for specialized HMOs amounted to about 0.37 percent on average, or about nine times more per premium dollar.

We developed four alternative assessment methodologies and found that two would both better reflect actual workload and reduce the disparity in financial impacts. Assessments under these two methods are based in whole or in part on the split in identifiable workload between specialized and full-service HMOs, and on total premiums received by individual HMOs.

We recommended that the Legislature consider changing the department's assessment structure to reflect the proportion of the documented workload that the department devotes to specialized and full-service HMOs and to reduce disparities in the financial effect on HMOs. We also recommended that the Legislature require the department to report to it triennially on the proportion of assessments charged to each class of HMO and the proportion of the documented workload related to each class of HMO.

***Legislative Action: Legislation passed.***

In May 2003, the governor approved legislation requiring full-service HMOs to pay for a larger share of the department's costs. Effective July 1, 2003, full-service HMOs will be required to pay 65 percent of the department's costs, not covered by other fees and reimbursements. Current law has no provision requiring the department to report triennially to the Legislature on the proportion of assessments charged to or the proportion of documented workload related to each class of HMO.

**Finding #2: The department is generally effective in meeting deadlines, but it must improve the timeliness of financial examinations and its responses to requested plan changes.**

The department has increased the output for some of its core functions, has introduced several new services for HMO enrollees, and is generally better at meeting deadlines when compared to the same functions previously carried out by the Department of Corporations (Corporations). For example, in the first half of fiscal year 2001–02, the department's Division of Plan Surveys completed 20 routine medical surveys (surveys) and ended calendar year 2001 with only four backlogged surveys. In contrast, Corporations had an output of seven surveys in the first half of fiscal year 1998–99 and 40 backlogged surveys at the end of calendar year 1998.

On the other hand, the department's Division of Financial Oversight is having difficulty completing financial examinations on time. Its backlog of 13 examinations at the end of calendar year 2001

compares unfavorably to the backlog of two examinations that Corporations experienced at the end of calendar year 1998. The Division of Financial Oversight has seen a large increase in its routine workload which, combined with staff vacancies and an increase in nonroutine work, contributed to the backlog. When the department does not complete financial examinations on time, the public is not fully informed of the financial status of HMOs.

In addition, the department's Division of Licensing has often failed to promptly notify HMOs of its decision regarding the HMO's requests to make significant changes, known as material modifications, to health plans. It was late in sending written notifications for 42 of the 122 material modification filings it received in 2001. According to department staff, workload issues may have been a factor contributing to late notifications. In addition, the Division of Licensing had no reliable means of tracking the status of its workload, and limitations in its manual processes made it difficult to ensure that statutory turnaround requirements were met. When the department does not notify HMOs of delays in approving their requests for changes, they are not able to respond to department concerns, resulting in delays in changes that the HMOs believe are necessary and significant.

We recommended that the department establish deadlines for the publishing of financial examination reports and closely monitor the success of its efforts to meet deadlines for these reports. In addition, we recommended that the department closely monitor the time elapsed between its receipt of requests for material modifications and the notifications it sends to HMOs, and make it a priority to send written notifications within the statutory deadline.

***Department Action: Corrective action taken.***

The department says it now includes target preliminary report and final report dates on its examination schedule and is making all reasonable efforts to remain compliant with statutory deadlines. It believes no examination reports are currently out of compliance with statutory deadlines. The department says that it has also taken steps to ensure that health plans are promptly notified of the status of their material modifications. Its attorneys are required to issue within the statutory 20-business-day period either (1) an order of approval, denial, or postponement or (2) a deficiency

letter, upon receipt of a written request from an HMO to extend the statutory period. The department says that through the third quarter of fiscal year 2002–03, with three exceptions, it issued orders of postponement or extensions for all material modifications it had not approved or denied within the statutory deadline.

# DEPARTMENT OF REHABILITATION

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## ***Its Delay in Correcting Known Weaknesses Has Limited the Success of the Business Enterprise Program for the Blind***

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### **Audit Highlights . . .**

*Our review of the Department of Rehabilitation's (department) administration of the Business Enterprise Program for the Blind (program) reveals that:*

- Program participants' (operators) average net income has increased, but 30 percent of them still earned less than the minimum wage in fiscal year 2000–01.*
- In May 2002 the department completed its first strategic plan for the program; however, the plan lacks defined outcomes and performance measures.*
- Although the department has been working for more than seven years to update its regulations, it has yet to do so.*
- The department has not ensured that partnerships between operators and private food-service businesses are consistent with federal law and pay their fair share of program costs.*

*continued on next page*

**REPORT NUMBER 2002-031, SEPTEMBER 2002**

**Department of Rehabilitation's response as of September 2003**

The California Welfare and Institutions Code, Section 19640.5, requires the Bureau of State Audits to conduct a fiscal audit of the Business Enterprise Program for the Blind (program) every third fiscal year until January 2002 and a programmatic review every five years until January 2003. This programmatic review is the last of the series of reviews required by the statute. The program trains qualified blind persons to operate their own food-service businesses and provides them with food service facilities located in government buildings throughout the State. Specifically, we found:

### **Finding #1: The department only recently provided strategic direction to its staff and participants.**

In May 2002, in conjunction with the California Vendor's Policy Committee, the Department of Rehabilitation (department) issued its first strategic plan for the program. The department's previous lack of action to establish strategic priorities for the program, identify expected outcomes, or offer methods to measure improvement hampered the program's ability to fulfill its mission and to address deficiencies in its operations that various audits identified as early as 1991. The plan does not reflect decisions regarding the prioritization of scarce resources, show which areas the department believes the program needs to improve the most, or provide any mechanism for the program to use to determine what level of resources to expend to attain planned objectives. Moreover, the current plan does not identify expected outcomes or offer performance measures or benchmarks. Consequently, the department might dedicate resources to an area but never be able to determine if the program has reached—or is moving toward—a stated goal.

- ☑ *Since August 1998 the program has not actively pursued the collection of past-due vending machine commissions from private companies.*
  - ☑ *The program does not adequately monitor operators or provide them with all required consulting services.*
- 

We recommended that the department, in consultation with the California Vendor's Policy Committee, should revise the program's strategic plan to include expected outcomes and performance measures so the department can evaluate the program's success and measure its progress in achieving strategic goals and improving noted deficiencies.

***Department Action: Corrective action taken.***

In its September 2003 response to our audit, the department reported that in consultation with the California Vendor's Policy Committee, it revised the program's strategic plan to include expected outcomes and performance measures.

**Finding #2: The department has not updated its guidelines for administration of the program.**

The department lacks guidance the program needs for sound administration. The program has neither updated its regulations nor provided updated policies for program administration to its staff. The lack of clear guidance may lead to disparate service delivery and compromise the program's success. State law and regulations require that every three years the department review and consider updating its regulations for the administration of the program. However, the department has been working for at least seven years to update the regulations. Because of this delay and the program's reliance on a 1994 policy and procedures manual that is outdated in some areas and provides insufficient guidance in others, the program has lacked clear guidelines on how it should operate. The program has not provided sufficient guidelines in its purchase of equipment and establishment of private partnerships. As a result, the department cannot ensure that the purchase of equipment is consistent among locations and that its private partnerships conform to federal law and its own mission statement. The department attributes its delay in updating its regulations on staff vacancies and on the magnitude and importance of the task; however, we found the department's reasons for not being able to establish guidelines to be unfounded. The department is currently developing a new draft of the proposed regulations, but it has not established timetables or deadlines to manage the process. The department intends to revise its policy and procedures manual to coincide with the new regulations once they are adopted.

We recommended that the department should aggressively and promptly pursue development of program regulations. If the current draft is too complex or lengthy, the program should consider breaking the draft regulations into segments, first identifying and addressing the highest priorities. The department should ensure that the guidelines include measures that will improve consistency in equipment purchase decisions, including a list of allowed and disallowed equipment and supplies, and statewide criteria for equipment purchase and replacement.

***Department Action: Pending.***

The department has not yet updated its regulations. However, it reported that it has drafted proposed regulations and plans to divide the proposed regulations into separate parts for submitting through the regulatory process based on program priorities. At the time of its September 2003 response, the department expected to finish dividing and prioritizing its proposed regulations in September 2003, and then to proceed with those regulatory changes it deemed are the highest priority. The department offered no expected timetable for completing the approval process of any of its proposed regulations.



The department disagrees with our finding that it lacks sufficient guidelines to ensure that staff members use the same standards or information to decide whether equipment purchases are warranted. The department reported that it believes its current system provides consistency and flexibility.

**Finding #3: By allowing operator partnerships with private businesses, the program has collected inequitable operator fees and may not have complied with federal law.**

By encouraging private partnership agreements between blind operators and private food service businesses, the department recently has allowed the private businesses to obtain program benefits that federal law intended for blind operators. Under a private partnership agreement, a contract between a program participant and a private food service business, the private business pays the program participant a monthly amount and in exchange is allowed to prepare and sell food at a program site in a state or federal building and to receive other program benefits such as consulting services and equipment maintenance.

We found numerous problems with the program's administration of its private partnership agreements. Specifically, it has not adequately ensured that its actions conform to the intent of the federal Randolph-Sheppard Act under which the program was created. Moreover, because it has not developed guidelines on when or how to implement the partnerships, it cannot be sure that the partnerships are allowable, prudent, or consistent or that they protect the interests of the State or the program participants. Because of the terms of the partnerships, the department has lost its ability to monitor the investment of program funds in these locations in the same way that it can monitor the use of program funds at other locations, and it has not obtained enough information from the partnerships to determine if they are successful business ventures. Further, although the program generally provides the same services to private partnerships that it would to other program participants, it allows some partnerships to pay disproportionately lower fees than other program participants pay.

To improve its administration of private partnerships, we recommended that the department take the following steps:

- Establish and follow guidelines for partnerships, ensuring that they are in agreement with federal and state law, regulations, and guidance.
- Require program staff to further study the cost and benefit of each partnership to ensure that future agreements do not inequitably drain program resources.
- Establish a review process for proposed private partnerships that allow the department to adequately protect the interests of the State and program participants.
- Monitor partnerships to enable the department to compare the costs and benefits of partnerships and determine if they achieve program objectives.
- Ensure that program staff are able to monitor the success of all locations, including private partnerships.

*Department Action: Pending.*

➤ The department reported that its proposed regulations address agreements between program participants and private entities and it reported that, in consultation with the California Vendors' Policy Committee, it will establish guidelines to ensure compliance with federal and state law, regulations, and guidance. However, the department did not provide us with an estimate of when these proposed regulations would be approved. At the time of its September 2003 response, the department had yet to determine what parts of its proposed regulations would be submitted for approval through the regulatory process.

➤ The department stated that it already evaluates the costs and benefits of agreements between program participants and private entities, but will review its evaluation process to ensure that the review adequately protects program resources.

➤ The department reported that it does not plan to establish a review process for proposed partnerships. It believes its current process adequately protects the interests of the State and program participants.

The department also reported that it would review its monitoring procedures to further its ability to compare the costs and benefits of agreements and determine if they achieve program objectives.

Further, the department reported that it will continue to monitor the success of all locations.

**Finding #4: The department has not corrected flaws in its process for pursuing past-due commissions, some of which may now be uncollectible.**

Since August 1998 the department has not actively collected past-due commissions owed to the program by private vending machine businesses operating on federal and state properties. The department's lack of pursuit of these past-due commissions may have rendered these commissions uncollectible. Moreover, the department's collection process is inadequate and its new database cannot track past-due commissions. This problem has been compounded because the department has not maintained all its contracts, conducted planned audits, and appropriately trained its collection staff.

We recommended that the department consider moving the commission-collection function to its accounting section, which already collects operator fees for the program and possesses the necessary collection knowledge and accounts receivable tracking system.

***Department Action: Corrective action taken.***

The department reported that it completed its evaluation of its resources and feasibility of moving the commission-collection function and has moved the commission-collection function to the department's specialized services division. It also reported that it has added an additional staff person to the commission-collection function and that it continues to refine its database.

**Finding #5: The department has not consistently met all of its responsibilities to program participants as required by law and its own regulations.**

By not fulfilling all its responsibilities to program participants in terms of training, feedback, and financial monitoring, the department may have hindered the ability of participants to succeed and engage in improved work opportunities. Specifically, the department has not complied with state law that requires it to provide the program's initial training in two locations, nor has it consistently provided upward mobility training as required by federal law. Further, the department has not always offered operators documented feedback that might enable them to increase the success of their facilities even though its own policies require that it give such feedback every three months. Finally, the department has not ensured that operators submit required financial reports and fees, and thus cannot readily identify operators who may be having operating difficulties and need assistance.

We recommended that the department offer program participants a second training location and ensure that it identifies and offers upward mobility training classes. Further, the department should track location reviews to ensure that business enterprise consultants complete the reviews at least quarterly. We also recommended that the department should ensure that consultants contact operators regarding missing monthly operating reports when they are a month or more delinquent as required by regulations, and

discontinue its practice of waiting 60 days before identifying delinquent monthly operating reports. Finally, the department should ensure that the program monitors operators adequately to prevent the accumulation of significant past due fees and lengthy delinquencies in reporting. When operators refuse to submit financial reports as required by regulations, the department should demonstrate it is willing to suspend and terminate operators' licenses to ensure compliance with program requirements.

***Department Action: Partial corrective action taken.***

The department reported that it completed an evaluation of the program's entire training program to ensure it meets the needs of program participants and the requirements of state and federal laws and regulations. As a result, the department has extended its annual licensing class for new participants, which it continues to provide in one location, from six months to eight months. It also reported that it will provide additional training at field office locations via teleconference or face-to-face for all its program participants at least annually. The department reported that it had provided training in four locations during 2003 and plans to provide training opportunities for participants and staff in the northern and southern part of the State at least once a year.

The department also reported that it has completed all required quarterly location reviews in the last two quarters of fiscal year 2002–03 and expects to complete all quarterly location reviews in fiscal year 2003–04. In addition, the department reported that it established a tracking system to ensure that required reviews are completed.

Further, the department reported that it reviewed its current process for entering operating report data and determined that it is the most cost-efficient method of entering the data. It also reported that it strengthened its use of its tracking system and emphasizes routine reporting and appropriate follow-up of operator status. Finally, the department reported that it will continue to pursue operators with delinquent reports and unpaid fees consistent with its available resources and priorities.

**Finding #6: The department has not corrected weaknesses in its process for assigning interim locations.**

In a previous report, issued in August 1997, we reported that the department's policy for classifying and circulating announcements for available locations was inequitable because it had not developed a fair process for assigning interim locations. To date, the department still has not corrected this weakness.

To ensure that its application and selection process for locations is equitable, we recommended that the department establish procedures to circulate announcements for all permanent and interim food service locations to eligible operators.

***Department Action: Pending.***

The department maintains that its established procedures to circulate announcements for all permanent locations and to select interim operators are appropriate and fair. However, the department reported that it has re-evaluated the procedures it uses to select interim operators and has included procedures in the proposed regulations to ensure all interested operators have equal opportunity to be considered for interim locations.

# DEPARTMENT OF HEALTH SERVICES

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## ***It Needs to Better Control the Pricing of Durable Medical Equipment and Medical Supplies and More Carefully Consider Its Plans to Reduce Expenditures on These Items***

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### **Audit Highlights . . .**

*Our review of the Department of Health Services' (department) purchasing and contracting practices for durable medical equipment (DME) and medical supplies under the California Medical Assistance Program (Medi-Cal) revealed that:*

- While the number of beneficiaries and related expenditures are increasing, federal funding for Medi-Cal is likely to decrease by \$222 million in fiscal year 2002–03.*
- The department's cost control procedures have not prevented significant spending increases for unlisted items—those with no established maximum allowable product costs (MAPCs).*
- It has been more than 15 years on average since the department last updated the MAPCs for many medical supplies.*
- The department's inadequate planning for two initiatives it believes will reduce its DME and medical supply costs—converting its medical supply billing codes to universal product numbers and negotiating contracts with manufacturers—may undermine their success.*

**REPORT NUMBER 2002-109, DECEMBER 2002**

**Department of Health Services' response as of January 2004**

The Joint Legislative Audit Committee asked us to examine the Department of Health Services' (department) purchasing and contracting practices for durable medical equipment (DME) and medical supplies under the California Medical Assistance Program (Medi-Cal). We found that the department's cost control procedures have been ineffective in reining in spending for items with no maximum allowable prices (unlisted items). In addition, the department has failed to ensure that it does not approve expenditures for unlisted DME items that should be charged under listed codes at a lower cost. Further, the department has delayed price updates for its medical supplies for an average of 15.5 years, and many of its product codes may be obsolete. Finally, the department's inadequate planning for two initiatives it believes will reduce its DME and medical supply costs may result in increased administrative costs and a failure to reduce expenditures.

### **Finding #1: The department's cost control procedures have been ineffective in reining in spending for unlisted items.**

The department's expenditures for unlisted DME and medical supplies have increased significantly over the past four years, and its cost control procedures have done little to rein in these expenditures. Specific areas our audit identified include:

- The department's payments for unlisted DME items accounted for most of the increases in expenditures for all DME. From 1998 through 2001, expenditures for unlisted DME increased by \$34.3 million, or 89.4 percent. Similarly, the department's expenditures for unlisted medical supplies increased, even though total medical supply expenditures have decreased in recent years. In 2001, the department paid 11.1 percent less

for medical supplies with established maximum prices, but 27.5 percent more for medical supplies without such prices than it did in 1998.

- Although state regulations require providers and manufacturers to provide Medi-Cal with rates that do not exceed the price they charge to the general public, in December 1997, the department instructed its field office staff to discontinue reviewing authorization requests for cost.
- Field office staff lack cost-comparison tools, such as functional equivalence tables, that would allow them to compare requested items to other items that perform the same essential functions. Because they lack this information, the field office staff must rely on their experience and judgment to determine whether amounts are appropriate. Further, because the department lacks cost-comparison tools that will allow its field office staff to make meaningful comparisons of the requested items with other available products, field office staff tends to approve a product regardless of cost as long as it is medically necessary.
- We found that other states have some procedures that the department may wish to consider adopting. For example, we found that New York's Medicaid program caps reimbursement for unlisted items at the lesser of 150 percent of the provider's acquisition cost, or the provider's usual and customary charge to the general public. Further, New York uses a voice-activated authorization system to process routine authorization requests and thus free up staff resources to perform other reviews.
- Field office staff do not ensure that providers use listed codes whenever possible or justify why they do not. By not doing so, the department may pay more for an unlisted item than it would pay for another listed or unlisted item that meets the patient's needs. In fiscal year 2001–02, the department paid an average of \$622 for wheelchairs with listed codes, but an average of \$3,121 for unlisted wheelchairs.
- While the department attributed the large difference in average prices for listed versus unlisted wheelchairs to obsolete maximum allowable product costs (MAPCs)—the department last updated its MAPCs for listed wheelchairs in 1985 (17 years ago)—we found that the department's failure to enforce cost control procedures also contributed to the rising cost of unlisted wheelchairs. For example, the department's June 1998 policy statement requires field

office staff to approve unlisted wheelchairs only if providers document information including why a listed code cannot be used for the equipment the patient needs, and that the requested wheelchair is the lowest cost item among other comparable brands or types that meet the patient's medical needs. However, field office staff apparently approve requests for prior authorization for all wheelchairs as long as the requests are accompanied by a physician prescription. Staff also allow the use of unlisted codes for all wheelchairs and components. Consequently, the department may be paying more than necessary for customized wheelchairs.

We recommended that the department should do the following to ensure that it receives a fair and reasonable price for DME, medical supplies, and hearing aids:

- Analyze its payments for unlisted DME and medical supplies to determine whether it should establish maximum allowable product costs for any of these items.
- Analyze periodically its expenditures to determine utilization of high-dollar items and possible causes for increases in expenditures.
- Consider developing a voice-activated authorization system for straightforward transactions to free staff resources for more complex prior authorizations or cost analyses.
- Develop tools, such as functional equivalence and price comparison tools, for its field office staff to compare prices among similar items for unlisted DME and medical supplies.
- Cap reimbursement for unlisted items at the lesser of a department-determined percentage of the provider's cost (e.g. 150 percent of cost) or the provider's usual and customary cost charged to the general public, and require providers to submit their cost information with claims for reimbursement.
- If the department does not wish to set this cap and require providers to submit cost information, it should enforce its requirement that providers of unlisted wheelchairs document why the wheelchair cannot be billed under listed codes and that the recommended wheelchair is the least costly of alternative items that meet patient needs.

***Department Action: Partial corrective action taken.***

The department reports that it has taken the following actions:

- The department continues to convert its current billing codes to the national Healthcare Common Procedures Coding System codes (national codes) as required by the federal government for compliance with the Health Insurance Portability and Accountability Act, and has already implemented eight of these national codes for pediatric wheelchairs. It expects to finish converting to the national codes by summer 2004, and once fully implemented, the department will use only national codes for all DME. The national codes clearly define specific products with established Medicare reimbursement rates, which the department will use when reimbursing Medi-Cal providers.
- The department has also sponsored legislation establishing DME maximum reimbursement rates at either 80 percent (non-wheelchairs) or 100 percent (wheelchairs) of the established Medicare rate. Consequently, once it finishes converting its billing codes to the national codes, the department will eliminate its current practice of reimbursing certain billing codes without an established Medicare maximum rate at up to 90 percent of the manufacturer's suggested retail price.
- The department established maximum quantity and frequency limits for 35 additional medical supply items.
- The department changed its pricing policy for medical supplies. Instead of setting reimbursement rates using the highest priced manufacturer's item within a given category, the department now uses the median priced manufacturer's item.
- In some instances, the department has reduced the mark-up a manufacturer can use to establish the average wholesale price from 35 percent above the dealer cost listed in the dealer catalog to 25 percent.
- The department now requires a copy of an approved treatment authorization request to accompany all claims for miscellaneous medical supplies billed to the program using unlisted codes.

- EDS, the Medi-Cal fiscal intermediary, now reviews expenditure data on a weekly basis to determine changes in payment patterns. The department assists with this review. It also uses EDS systems to track payment changes weekly and over time.
- In lieu of creating a voice-activated system, the department developed a less-costly way to implement authorization controls to prevent recipients exceeding the department's limit for selected medical supplies. It established a per-beneficiary, per provider limitation on certain supplies and uses the claims processing system to check claims for beneficiaries who exceed the department's limit by using multiple providers.
- The department is reviewing price data, product specifications, features, and other product information for DME as part of its contracting activities. The department plans to use this data to revamp and update field office tools that staff can use to select the least expensive type of item that meets the patient's needs.
- With the passage of the 2003-04 Budget Trailer Bill, the department changed its reimbursement methodology for all DME. For those items with a maximum allowable rate for California established under the Medicare program (maximum allowable rate), the new reimbursement rates are generally stated as a percentage of the lowest maximum allowable rate. For those DME items without a maximum allowable rate, the reimbursement rate is generally the lower of the amount billed, a percentage of the manufacturer's suggested retail price, or cost plus a percentage markup.

**Finding #2: The department overpaid for some rentals.**

Field office staff's misunderstanding of regulations may have caused the department to pay \$8.3 million more for renting stationary volume ventilators over three years than the department would have paid by purchasing these items. Our review found that the department would have paid \$4.1 million if it had purchased these items, rather than the \$12.4 million it paid for renting them. Field office staff stated that regulations require them to approve only rentals of ventilators and prohibit them from purchasing them, which we found to be a misunderstanding of the regulations.

We recommended that the department clarify its rental policies with its field office staff to ensure that overpayments for DME rentals are not occurring.

***Department Action: Partial corrective action taken.***

The department states that it is currently exploring implementing a “capped” rental reimbursement methodology on some DME items.

**Finding #3: The department has not kept its codes and prices current and may not be receiving the lowest rates offered by providers or manufacturers.**

The department has been lax in updating its prices for items with MAPCs, and it may not be getting the same rates offered by providers or manufacturers to the general public. Specifically, we found the following:

- While technology improvements have made some items less expensive, the department has been lax in updating its prices for these items, and may be missing out on savings opportunities on these items. For example, the department issued only 10 operational instructional letters to its fiscal intermediary in the past three years. Of these 10 letters, only four actually updated a price on file, and those updates affected the MAPC for only seven of thousands of product codes for DME, medical supplies, and hearing aids.
- The department may be hampered in updating DME and hearing aid rates on a timely basis because these rates are established in regulations. In order to change these rates, the department must initiate and obtain approval for a change to the regulations, which can be a lengthy process.
- Although state regulations require the department to update its medical supply rates no less than every 60 days, on average for those medical supply product codes billed during fiscal year 2001–02, the department allowed 5,720 days, or about 15.5 years to elapse between price updates. This could potentially cost the department money. For example, we found that for two product codes the department could save an additional \$911,000 by making sure to update its prices in fiscal year 2002–03.

For those items for which it has established maximum allowable product costs, the department should ensure that it reviews and updates these rates on a regular and frequent basis. Further, to enable the department to become more responsive to changes in prices, the department should seek legislation to remove prices for DME and hearing aid items from regulations.

***Department Action: Partial corrective action taken.***

The department states that it hopes its ongoing universal product number (UPN) project will resolve issues with keeping its codes and prices current. The department is continuing to collect data on UPN codes to determine the availability of these codes for DME. Additionally, the department states that its contract renegotiation process will serve as a mechanism for determining if reimbursements need to be adjusted thereby providing the department a process for reviewing and updating rates.

Additionally, with the passage of the 2003-04 budget trailer bill, the department was given the authority to establish maximum allowable reimbursement rates and utilization controls in provider manuals, and is no longer required to promulgate regulations to add, delete, or change a covered service or reimbursement rate.

**Finding #4: The department has not fully considered the challenges and costs of implementing its cost-savings plans.**

To combat the rising costs of DME and medical supply items, the department plans to implement the following two cost-savings measures in the near future:

- The department hopes to convert its medical supply codes from the current federally required billing code structure to the more detailed universal product number (UPN) codes to gain more relevant and timely information on the products it pays for.
- The department plans to implement negotiated contracts for some DME and medical supply items.

While both plans could potentially reduce the department's costs, both could also increase expenditures if the department fails to properly plan and support these actions—yet the department's plans remain vague, incomplete, and unfocused.

For example, the department has not discussed its contract negotiation plans with providers or manufacturers who may prove to be resistant to the department's efforts.

In order to realize future cost savings for Medi-Cal, the department should continue to develop and use a UPN structure for medical supplies and contract negotiations for its DME items. However, the department should ensure that it adequately plans and considers possible limitations of its efforts. Further, the department should bring manufacturers and providers into its planning sessions as soon as possible.

***Department Action: Partial corrective action taken.***

The department states that it is continuing its efforts to develop a UPN structure for medical supplies and DME, and plans to thoroughly study the benefits, possibilities, and limitations of using UPNs for billing. The department estimates that this project will take a minimum of two to three years to fully implement. The department further states that it is pursuing an exception from the national coding requirements for DME and medical supplies to allow it to demonstrate the feasibility and cost effectiveness of the UPN as a coding standard.

# STATEWIDE FINGERPRINT IMAGING SYSTEM

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## ***The State Must Weigh Factors Other Than Need and Cost-Effectiveness When Determining Future Funding for the System***

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### *Audit Highlights . . .*

*Our review of the California Department of Social Services' (Social Services) Statewide Fingerprint Imaging System (SFIS) revealed:*

- Social Services implemented SFIS without determining the extent of duplicate-aid fraud throughout the State.*
- It based its estimate of the savings that SFIS would produce on an evaluation of Los Angeles County's fingerprint imaging system, rather than conducting its own statewide study.*
- Because Social Services did not collect key statewide data during its implementation of SFIS, we are not able to determine whether SFIS generates enough savings to cover the estimated \$31 million the State has paid for SFIS or the estimated \$11.4 million the State will likely pay each year to operate it.*
- In deciding whether to continue SFIS, the Legislature should consider the benefits SFIS provides as well as what appears to be valid concerns regarding the system, such as the fear it may provoke in immigrant populations eligible for the Food Stamp program.*

REPORT NUMBER 2001-015, JANUARY 2003

Department of Social Services' response as of December 2003

Chapter 111, Statutes of 2001, directed the Bureau of State Audits (bureau) to conduct an audit of the Department of Social Services' (Social Services) Statewide Fingerprint Imaging System (SFIS). This system was designed to detect duplicate-aid fraud. The bureau was asked to report on the level of fraud detected through SFIS; the level of fraud deterrence resulting from SFIS; SFIS's deterrence of eligible applicants, especially the immigrant population, from applying for public benefits; and SFIS's cost-effectiveness.

### **Finding #1: Social Services did not know the extent of duplicate-aid fraud before implementing SFIS.**

Before SFIS was in place, estimating how much duplicate-aid fraud actually existed in the State was difficult. Social Services was aware only of potential cases of duplicate-aid fraud that the counties brought to its attention. The methods the counties used to detect duplicate-aid fraud prior to SFIS met the federal requirement and were similar to those used in other states. According to our survey, the counties used computer matches as the primary method to detect possible duplicate-aid fraud, followed closely by tips from concerned citizens or other organizations. Data from the counties responding to our survey regarding the number of duplicate-aid fraud cases identified prior to the implementation of SFIS did not suggest to us that duplicate-aid fraud was a serious problem.

Social Services had a few options available for determining the known extent of duplicate-aid fraud in the State prior to implementing SFIS. For example, it could have surveyed the counties as we did or requested counties to analyze their Integrated Earnings Clearance/Fraud Detection System and

DPA 266 data to determine the extent of duplicate-aid fraud. The DPA 266 is a report that tracks, among other things, statewide statistics on duplicate-aid investigation requests.

We raised concerns regarding the accuracy and completeness of the DPA 266 in our March 1995 report, titled *Department of Social Services: Review and Assessment of the Cost Effectiveness of AFDC Fraud Detection Programs*. Social Services has not resolved fully its problems with the DPA 266. Our survey results indicate that the counties do not report information consistently on the DPA 266, and therefore it is an unreliable report.

According to the chief of its fraud bureau, Social Services no longer verifies the accuracy of the information the counties report, because it does not consider the DPA 266 to be a statistical or claiming document but merely an activity report. However, this statement is inconsistent with Social Services' instructions for completing the DPA 266, which state that information collected on the DPA 266 is used to prepare a federal program activity report and special reports for the Legislature. Specifically, federal regulations require state agencies to submit to the United States Department of Agriculture (USDA) an annual program activity statement that includes data on investigations of fraud. If Social Services had captured more detailed and reliable data using the DPA 266, it may have been able to present a clearer picture of the extent of duplicate-aid fraud identified by the counties.

To ensure that it reports accurate and complete information to the USDA, Social Services should require the fraud bureau to incorporate the review of DPA 266 data into its on-site visits to counties.

***Social Services' Action: Pending.***

Social Services stated that its fraud bureau is in the process of developing procedures to verify the accuracy of the DPA 266 data and will incorporate these procedures into its on-site visits to counties.

**Finding #2: During implementation, Social Services missed its opportunity to determine SFIS's cost-effectiveness.**

Social Services and the Health and Human Services Agency Data Center (data center) did not capture critical data during the implementation phase that would have allowed them to

quantify the savings attributable to SFIS. For example, each month two randomly selected groups of cases would be drawn from a subset of counties implementing SFIS over a six-month period to establish a control group and an experimental group of recipients. Individuals in the control group would not be fingerprinted, but individuals in the experimental group would be fingerprinted. Then the amount of benefits paid to each group in the first calendar month in which SFIS had its full effect on the experimental group would be used to calculate an initial savings amount. The recidivism rate—the rate at which individuals previously terminated from receiving aid return to aid—would be tracked for each county for one year and used to adjust the initial savings.

The deputy director of Social Services' Welfare-to-Work Division told us that in mandating SFIS, the Legislature did not provide any statutory authority or resources to require counties to collect data. Although we agree that state law mandating SFIS neither explicitly mandates the collection of data nor provides funding for these efforts, it does require Social Services and the data center to design, implement, and maintain the system. Moreover, other state laws and policies establish the State's expectations for implementing information technology (IT) projects. For example, state law holds the head of each agency responsible for the management of IT in the agency that he or she heads, including the justification of proposed projects in terms of cost and benefits. Further, state policy requires agencies to establish reporting and evaluation procedures for each approved IT project and to prepare a post implementation evaluation report that measures the benefits and costs of a newly implemented IT system against the project objectives. The State does not consider a project complete until the Department of Finance approves the post implementation evaluation report. Data collection is a key component in preparing this report. Therefore, the data center and Social Services were remiss in not bringing the lack of authority and resources to the Legislature's attention so they could effectively implement SFIS. Moreover, because counties did not begin to use SFIS until March 2000, roughly four years after the passage of the law, it is reasonable to conclude that the data center and Social Services had ample opportunity to do so.

To ensure that its implementation of future IT projects meets state expectations, Social Services and the data center should collect sufficient data to measure the benefits and costs against the project objectives. They also should identify promptly any obstacles that may prevent them from implementing effectively the project.

*Social Services' Action: Pending.*

Social Services and the data center stated that they will continue to adhere to all appropriate IT policies and processes, and identify obstacles that may prevent an appropriate analysis of impacts of the IT project.

**Finding #3: Incomplete cost data and a flawed method for estimating savings renders Social Services' cost-benefit analysis for SFIS unreliable.**

Social Services tracks some of the costs associated with SFIS, but it does not track county administrative costs. As a result, it does not know the full costs of operating SFIS. Further, because Social Services did not capture the data necessary to determine the savings attributable to SFIS during its implementation, Social Services developed an estimate based on the results of Los Angeles County's AFIRM demonstration project. However, the methodology it used to estimate the State's savings of roughly \$150 million over five years for SFIS is flawed and therefore unreliable.

Although we were able to substantiate the data center's and Social Services' costs, we were not able to determine the counties' actual costs because Social Services did not require counties to track SFIS administrative costs separately. Social Services estimated that the total administrative costs that all counties except Los Angeles incurred for CalWORKs and the Food Stamp program for fiscal year 2000–01 would be roughly \$1.8 million, yet Riverside County told us that its estimated costs for the same fiscal year were roughly \$1.4 million; Riverside County alone estimated its costs as amounting to 78 percent of the costs Social Services estimated for 57 counties. Additionally, Social Services' estimate does not include the cost that counties incur for investigating possible fraudulent activity. Furthermore, Social Services chose not to include any administrative costs for Los Angeles County in its estimate because the county had not yet implemented SFIS. Therefore, Social Services may be understating the cost of implementing and operating SFIS substantially.

Social Services' November 2000 estimate also attempts to quantify benefits or savings that would accrue to the CalWORKs and Food Stamp programs. The estimate does not include savings attributable to the avoidance of duplicate-aid fraud in the Food Stamp program because the data was

not available. Further, Social Services did not include savings resulting from Los Angeles County's use of SFIS because the county was not yet using SFIS when Social Services built the estimate. Finally, Social Services used data from Los Angeles County's demonstration project to support key assumptions in its development of the SFIS savings estimate, which is inappropriate because it assumes that these conditions hold true in other counties. In fact, Social Services was unable to provide documentation to support some of its key assumptions.

To improve its management of SFIS, Social Services should identify the full costs of operating SFIS by requiring counties to track their administrative costs separately. To ensure that its estimates are representative of the entire state and its key assumptions are defensible, Social Services should study the conditions of a sample of counties instead of assuming that conditions in one county hold true in other counties and maintain adequate documentation, such as time studies or other empirical data to support its estimates.

***Social Services' Action: Pending.***

Social Services disagreed that it should separately track SFIS administrative costs, stating that these costs are included in general eligibility determination activities in the State's federally approved cost allocation plan. Social Services' failure to recognize the importance of these costs causes us concern. Until Social Services understands the total cost of operating SFIS, the State cannot properly evaluate the system in terms of costs and benefits.

Social Services agreed that maintaining adequate documentation to support its estimates is important and believes that in most instances sampling several counties is a better representation of the entire state. However, Social Services stated that, in the case of SFIS, it and the Legislature appropriately relied on data from Los Angeles County's demonstration project since it was specifically designed to test fingerprint imaging and because Los Angeles County represents 40 percent of the statewide public assistance caseload. Nonetheless, Social Services asserted that it has processes in place to assure that assumptions are appropriately documented.

**Finding #4: The majority of matches SFIS identifies are administrative errors, and the actual level of fraud it detects is quite small.**

Although Social Services does not know how many applicants SFIS deters from attempting to receive duplicate-aid, it can determine the number of applicants that SFIS detected who were attempting to receive duplicate aid. However, we found that the actual number of matches SFIS has identified as possible fraudulent activity is substantially fewer than the number of matches it identifies as administrative errors made by county staff. Between March 1, 2000, and September 30, 2002, SFIS detected a total of 25,202 matches, 7,045 which were still pending resolution as of September 30, 2002. Of the remaining 18,157 items with a final disposition, staff identified only 478 of the items, or roughly 3 percent, as possible fraud situations. Further, investigators found fraud in only 45 of the 478 possible fraud items, just 0.2 percent of the 18,157 items resolved, according to SFIS reports. In order to determine how long items had been pending resolution, we asked for an aging report as of October 21, 2002. We found that roughly 3,000 of the 4,920 matches shown as pending resolution in SFIS were more than 99 days old, and 1,100 had been pending for a year or more. Social Services told us that it generates monthly reports from SFIS that allow it to see whether counties are investigating and resolving discrepancies but that it reviews these reports in detail only twice a year. Moreover, although Social Services provides training and instructs counties to promptly resolve any matches that SFIS identifies, it does not have a regulation, policy, or set of procedures requiring counties to do so. Additionally, Social Services has yet to develop written procedures for its own staff to follow when reviewing reports that SFIS generates. Without policies and procedures, Social Services cannot ensure that SFIS information remains current, which can diminish its usefulness.

To improve its management of SFIS, Social Services should establish policies and procedures that require counties to resolve pending items in the resolution queue promptly. Additionally, the fraud bureau should develop written procedures for its staff to follow up on items pending in the resolution queue. The procedures should include fraud bureau staff requesting a monthly aging report to use as a tool to determine whether items pending in the resolution queue are current and, if necessary, contacting the appropriate counties. Furthermore, Social Services should ensure that counties investigate and record the outcomes of their investigations in SFIS.

***Social Services' Action: Corrective action taken.***

Social Services stated that it has developed an aging report for use as a tool to monitor pending items in the resolution queue. Further, it told us that written procedures to guide its staff in following up with counties to resolve pending cases have been developed.

**Finding #5: Social Services does not collect the data it needs to determine if it is successful in reaching its Food Stamp program target populations.**

California's Legislature voiced its concern over low participation rates by requiring Social Services to develop a community outreach and education campaign to help families learn about and apply for the Food Stamp program. In an annual report to the Legislature dated April 1, 2002, Social Services stated that it believes its outreach efforts have had an effect on increasing the number of applications received and the caseload of the Food Stamp program. However, the Legislature specifically instructed Social Services to identify target populations and report on the results of its outreach efforts. Social Services identified two target populations: families terminating from CalWORKs and legal noncitizens. Although Social Services recognizes that the ultimate measurement of its outreach efforts' success depends on its ability to reach the target population, it did not collect data to evaluate the participation rates of these two populations. Instead, it chose to rely on the USDA's report of estimated state Food Stamp program participation rates, which presents information that is up to three years old. Furthermore, the USDA's report does not have information specific to Social Services' target populations. Therefore, Social Services does not know if its efforts to reach legal noncitizens have been successful.

To report accurately the results of its community outreach and education efforts to the Legislature, Social Services should establish a mechanism to track the participation rates of the target populations.

***Social Services' Action: Corrective action taken.***

Social Services stated that it has contracted with the University of California, Los Angeles, to collect data necessary to track non-citizens' participation in the Food Stamp program. Social Services believes that this data, in combination with data from the federal census, will allow it to track non-citizen participation over the years.

**Finding #6: Decision makers should consider the benefits and drawbacks of SFIS when deciding future funding for the system.**

The primary benefits that the State derives from continuing to use SFIS are the proven effectiveness of fingerprint imaging technology to identify duplicate fingerprints and its ability to identify applicants who may travel from county to county seeking duplicate aid. However, several factors could also support discontinuing the use of SFIS. For one, the State is spending \$11.4 million or more annually to operate SFIS without knowing the actual savings that it may be producing. Additionally, although we were not able to verify some of the concerns that opponents of SFIS raised, other concerns appear valid. For example, the fingerprint imaging requirement may add an element of fear to the welfare application process and thus may keep some eligible people from applying for needed benefits. The State must weigh these factors in deciding whether to continue to fund SFIS.

The Legislature should consider the pros and cons of repealing state law requiring fingerprint imaging, including whether SFIS is consistent with the State's community outreach and education campaign efforts for the Food Stamp program. To assist the Legislature in its consideration of the pros and cons of repealing state law requiring fingerprint imaging, Social Services and the data center should report on the full costs associated with discontinuing SFIS.

***Legislative Action: Legislation proposed.***

The Legislature is currently considering Assembly Bill 1057 (Lieber), which proposes to repeal the requirement for Social Services to use SFIS. This bill is currently in the Assembly Committee on Human Services.

*Social Services' Action: Pending.*



Social Services agreed, but stated that it has previously provided this information to the Legislature. Social Services did not state clearly the actions it will take to address our recommendation.



# DEPARTMENT OF HEALTH SERVICES

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## ***Its Efforts to Further Reduce Prescription Drug Costs Have Been Hindered by Its Inability to Hire More Pharmacists and Its Lack of Aggressiveness in Pursuing Available Cost-Saving Measures***

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### **Audit Highlights . . .**

*Our review of the Department of Health Services' (Health Services) practices for containing Medical Assistance Program (Medi-Cal) pharmaceutical costs found the following:*

- Health Services may not fully achieve the roughly \$104 million General Fund cost savings it predicted for fiscal years 2002–03 and 2003–04 because it has been unable to hire pharmacists, has not considered fully the consequences of some planned activities, and has presented questionable estimates.*
  - Although Health Services employs some cost-saving strategies, such as the List of Contract Drugs, it has been slow to consider or adopt others.*
  - Its efforts to educate physicians and pharmacists about inappropriate or medically unnecessary drug therapy are limited.*
  - Health Services has not sought funding for disease management pilot projects that could potentially benefit the Medi-Cal population.*
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**REPORT NUMBER 2002-118, APRIL 2003**

**Department of Health Services' response as of October 2003**

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits examine current practices for containing Medicaid pharmaceutical and related expenditures and to assess the extent to which these practices can be or are applied to the Department of Health Services' (Health Services) Medi-Cal Fee-for-Service drug program. As part of the audit, the audit committee asked that we conduct a survey of selected states' Medicaid program practices aimed at containing costs. Further, the audit committee requested that the survey include, but not be limited to, other states' pharmacy reimbursement practices, policies to encourage the use of generic drugs, drug formulary practices, timely collection of rebates from manufacturers, establishment of disease management programs, and the net costs of drugs. Additionally, we were to compare Health Services' current practices with the cost containment practices of the California Public Employees' Retirement System (CalPERS). Using the data obtained from the surveyed states and CalPERS, we were asked to assess the applicability of the data to Medi-Cal and, if applicable, determine the extent to which Health Services uses such practices. Finally, we were asked to assess Health Services' staffing levels and contracting needs for carrying out its Medi-Cal pharmaceutical functions. Specifically, we found that:

### **Finding #1: Health Services has been unable to hire needed pharmacists.**

Health Services has not been able to fill pharmacist positions approved during budget negotiations for fiscal years 2001–02 and 2002–03 to meet increases in its workload and to implement several budget reduction proposals. Additionally, although Health Services contracted with its fiscal intermediary, Electronic Data Systems Federal Corporation (EDS), for the services of five more

pharmacists, as of March 2003, it had also been unable to hire the pharmacists. Consequently, Health Services had not performed some of its ongoing duties as promptly as it could. Further, we question whether Health Services will fully achieve the cost savings that it estimated for fiscal years 2002–03 and 2003–04.

According to Health Services, it has failed to increase its pharmacist staff because its ability to recruit individuals with the appropriate knowledge and skills is hampered by the disparity between the salaries it can offer and those offered in the private sector, and there is a shortage of pharmacists in the State. However, Health Services' efforts to advertise open positions have consisted of sending more than 4,000 notices to licensed pharmacists in the counties surrounding Sacramento.

Health Services agreed that it should pursue other approaches to attempt to meet its staffing needs. For example, Health Services might be able to reassign general pharmacist duties to a nonpharmacist position that requires a lesser level of expertise and might be easier to fill. However, Health Services points out that the nonprofessional classifications have a federal reimbursement rate of 50 percent, 25 percent lower than the professional classifications, which may have a greater impact on the State's General Fund. Another option available to Health Services is to use interns from a pharmacy school, such as the University of the Pacific in Stockton, to assist its pharmacists in performing some of their duties.

To address its difficulties in attracting qualified pharmacists, we recommended that Health Services should do the following:

- Broaden its recruitment efforts beyond the counties of Sacramento and San Joaquin to all of California and advertise in pharmacy periodicals. If necessary, it should seek the appropriate approvals to expand its recruitment efforts beyond California.
- Perform an analysis to identify the number of staff it needs to meet its federal and state obligations. The analysis should include a reevaluation of the duties assigned to the pharmacist classifications to identify those that could be performed by nonpharmacist classifications. Further, it should quantify the effect that using nonpharmacist staff has on its federal reimbursement for personnel costs.
- Research its ability to use the services of interns.

***Health Services' Action: Partial corrective action taken.***

Health Services indicated that it sent flyers to every pharmacist in the State and placed advertisements in a number of pharmacy publications. After receiving the approval of the Department of Personal Administration for a recruitment and retention payment of \$2,000 per month, Health Services stated that it recruited and hired four pharmacists in October 2003. However, Health Services does not believe seeking the appropriate approvals to expand its recruitment efforts beyond California would be fruitful, due to the State's more stringent licensing requirements.

Additionally, Health Services stated it has reclassified three unfilled pharmacist positions to analyst positions for database creation and analysis to assist the pharmacists. Finally, Health Services also indicated that it is continuing to seek interns from the University of the Pacific in Stockton, but has been unsuccessful in obtaining a proposal from the university.

**Finding #2: Health Services does not complete many drug reviews promptly.**

Between October 1999 and November 2002, it has taken Health Services as long as, and in a few instances longer than, one year to review new drugs before adding them to its drug list. Health Services has not established a deadline that addresses how long the entire new-drug process should take for drugs without a priority designation. It believes a reasonable time frame to conclude a new-drug review is roughly four to eight months.

As part of its review of new drugs, Health Services negotiates with drug manufacturers for state supplemental rebates. Delays in finalizing its negotiations for the supplemental rebates could result in Health Services paying higher prices for the new drugs than it otherwise would pay. Health Services attributes many of the delays in completing new-drug reviews to the drug manufacturers' lack of responsiveness and difficulties that arise during negotiations in addition to its inability to hire pharmacists to perform the new-drug reviews.

We recommended that Health Services revise its procedures for performing new-drug reviews to include a timeline for completing reviews and specific steps on how staff should address manufacturers' nonresponsiveness.

***Health Services' Action: Pending.***

Health Services indicated that it has increased the number of pharmacists who can negotiate contracts and is making changes so that it can complete new drug reviews more timely. For example, its staff are reviewing drafts of new or updated procedures for drug reviews, contract processes, and recordkeeping.

**Finding #3: Health Services could further reduce costs by completing more reviews of entire drug categories.**

Between 1998 and 2002, Health Services has only performed four therapeutic category reviews (TCRs) for the 113 classes of drugs on the drug list. A TCR entails reviewing all the drugs in one therapeutic or chemical drug category included in the drug list and negotiating supplemental rebate contracts for new or existing drugs on the drug list that are in that category. Health Services' procedures require it to develop a TCR schedule annually and make it available to the public on request. Yet, in 2002, Health Services did not develop a TCR schedule. In addition, Health Services reported in its November 2002 budget estimate that by performing TCRs of the drugs included in the categories of atypical antipsychotics and nonsteroidal anti-inflammatory drugs, it could achieve cost savings of almost \$39 million in fiscal year 2002–03 and more than \$46 million in fiscal year 2003–04. However, it has yet to perform any of these TCRs because under its current staffing situation, it is unable to do so.

We recommended that Health Services conduct the TCRs specified in its budget proposal for fiscal year 2002–03. Further, it should develop and adhere to annual schedules for future reviews.

***Health Services' Action: Pending.***

Health Services noted that the Legislature revised the law to require it to complete a TCR within 120 days instead of 150 days. Additionally, Health Services plans to complete four TCRs annually. Health Services also stated that it has hired and is training pharmacists to perform TCRs for cholesterol-lowering agents (statins) and anti-hypertensive (ace inhibitors) drugs.

**Finding #4: The State is relying on other cost-saving strategies that may not be fully realized or may be delayed.**

Health Services' original budget for fiscal year 2002–03 included certain cost savings totaling \$127 million for pharmacy benefits provided to Medi-Cal beneficiaries. However, by November 2002, when it began the budget process for fiscal year 2003–04, Health Services had not implemented some activities related to these cost savings and had to reduce the estimated savings to about \$80 million for fiscal year 2002–03. It estimated savings for fiscal year 2003–04 of \$127 million. However, it may not fully achieve the added cost savings identified in the November 2002 estimate, or the savings may be delayed. Specifically, we found the following:

- Health Services has not routinely established supplemental rebate contracts with manufacturers of generic drugs, although it has clear authority to do so. Health Services told us that it has not aggressively pursued supplemental rebates for generic drugs because of its inability to hire pharmacists and the reluctance of generic drug manufacturers to negotiate lower prices. Yet, Health Services reported that it could achieve cost savings of roughly \$40 million to the General Fund for fiscal years 2002–03 and 2003–04, by pursuing supplemental rebate contracts with generic drug manufacturers. However, because of the difficulties Health Services has experienced in filling vacant pharmacist positions, we question whether it will achieve this cost savings.
- Health Services may not be successful in achieving savings that result from a change it developed for one of its three predetermined pharmacy reimbursement rates. Specifically, a trailer bill to the budget act for fiscal year 2002–03, Assembly Bill 442 (AB 442), requires Health Services to base the maximum allowable ingredient cost (MAIC) on the mean of the wholesale selling price (WSP) of a generic drug from selected major wholesale distributors. The MAIC is the price set by Health Services for a generic drug. State law defines the WSP as the price, including discounts and rebates, paid by a pharmacy to a wholesale drug distributor for a drug. According to Health Services, it plans to ask selected wholesalers in California to report their WSPs for generic drugs and it intends to use the reported WSP plus an appropriate markup to reimburse pharmacies for each drug ingredient cost. Health Service reported that, once implemented, the new reimbursement method will provide cost savings of roughly \$9 million to the General Fund

for fiscal years 2002–03 and 2003–04. However, we again question whether Health Services will achieve these cost savings for several reasons that include its difficulties in hiring pharmacists to implement this new reimbursement method and its lack of a plan to address what action it will take if wholesalers are unwilling to share their pricing data.

- Another cost-saving activity that AB 442 requires Health Services to perform is creating a subset of the existing drug list—a preferred prior-authorization drug list (sublist). Health Services’ drug list is a list of preferred drugs that a physician can prescribe and for which a pharmacy can seek reimbursement without first obtaining approval from Health Services through its treatment authorization request (TAR) process. Although pharmacists will still have to submit TARs and provide justification for prescribing drugs not included on the drug list, it will require pharmacists to take even greater steps to justify and document reasons for selecting a drug that is not included on the sublist.

According to Health Services, the sublist will contain drugs that were deleted from the drug list or were not approved for addition to the drug list. It would add drugs to the sublist after evaluating the drug using certain criteria, including the cost of the drug, which is partially driven by the willingness of the manufacturer to negotiate a supplemental rebate contract. However, we question the necessity of a sublist given the additional workload this process would create. Specifically, Health Services’ proposal might require it to re-review drugs it has already subjected to the new-drug review process. The increased workload to implement the sublist would further overburden a staff already unable to complete their required tasks. Health Services reported that implementing the sublist would result in cost savings to the General Fund totaling \$9 million for fiscal years 2002–03 and 2003–04. However, according to Health Services, its cost-saving estimate was based on a cursory review of drug utilization by private third-party payers, yet, it could not provide us with the documents to support its review. Therefore, we cannot verify the accuracy of the estimate or determine whether the savings exceed the costs associated with the increase in Health Services’ workload.

- Finally, AB 442 also added language that prohibits manufacturers from making retroactive adjustments to federal and state rebates owed as a result of revisions to their best prices or average manufacturer price (AMP)—the average

prices paid by wholesalers for drugs distributed to the retail class of trade, which is reported to the federal government by manufacturers. Currently, federal law requires drug manufacturers to pay rebates based on their AMP and best price data, but the federal rebate agreement allows manufacturers to make adjustments to their AMPs or best prices. For Medi-Cal, these adjustments can affect payments manufacturers made in prior quarters for not only the federal rebates but also state supplemental rebates, which are often based on AMPs. Health Services told us that this has resulted in California having to pay back rebates or provide manufacturers with credits toward future rebate payments. By prohibiting manufacturers from retroactively adjusting federal and state rebates owed, Health Services reported that it could achieve \$13 million in savings to the General Fund for fiscal years 2002–03 and 2003–04.

However, before proposing this legislative change, Health Services should have obtained approval from the federal Centers for Medicare and Medicaid Services (center) to allow it to prohibit manufacturers from making retroactive adjustments to the federal rebates they owe based on revisions to their AMPs or best prices. According to Health Services, it anticipates that when it eventually refuses to make retroactive changes to the federal rebates, manufacturers will protest because their agreement with the federal government allow them to make adjustments. Therefore, Health Services indicated that ultimately it might need to seek a revision to state law to exclude federal rebates. Although state law will protect the State's supplemental rebate portion of the cost savings, if Health Services does not receive or further delays obtaining federal approval, it is unlikely the full savings related to protecting the federal rebates can be achieved.

To ensure that it fully achieves the added cost savings identified in the November 2002 estimate, we recommended that Health Services should do the following:

- Negotiate state supplemental rebate contracts with manufacturers of generic drugs, as the Legislature intended.
- Obtain written assurance from drug wholesalers that they will provide their wholesale selling prices so that it can compute the new MAIC for generic drugs. If the wholesalers are not willing to provide this information, Health Services should seek legislation to compel them to do so.

- Perform an analysis to support its proposal to create a preferred prior-authorization list. The analysis should include an evaluation of the impact this proposal has on its workload and adequate documentation to support its estimated savings.
- Seek federal approval from the center to prohibit manufacturers from making retroactive adjustments to federal rebates owed as a result of revisions to their AMPs or best prices.

***Health Services' Action: Pending.***

Health Services stated that it has solicited contract proposals from five manufacturers of generic drugs and, if the manufacturers respond, Health Services expects to execute contracts in February 2004.

Health Services stated that it met with wholesalers in October and November 2003 to obtain written agreements with wholesalers to supply their wholesale selling prices. It plans to hold one more meeting by the end of 2003.

Health Services indicated that it believes a preferred prior authorization list would be cost effective, but it did not provide an overall analysis to support this contention. Instead, Health Services stated that it plans to analyze the cost effectiveness of a preferred prior authorization list on a drug-by-drug or therapeutic drug category basis. Health Services noted that it analyzed the therapeutic class of drugs used in the treatment of multiple sclerosis. Although, it concluded that it should include the least costly product on its preferred prior authorization list, Health Services did not quantify the potential savings to the State.

Finally, Health Services indicated that the center has released a regulation for public comment that would allow manufacturers to make retroactive adjustments to their AMPs or best prices for a three-year period. However, this new regulation still conflicts with Health Services' legislation that permanently bars manufacturers from adjusting their AMPs or best prices retroactively. Health Services stated that it is seeking the centers' concurrence to allow California's existing law to supercede the new federal regulation.

**Finding #5: Health Services just recently began working with manufacturers to reconcile federal and state rebates.**

In a March 1996 audit, we reported that although Health Services prepared invoices specifically for supplemental rebates, the invoices did not specify the amount the manufacturers owed. Rather, the invoices instructed manufacturers to calculate and submit required supplemental rebates along with their federal rebate payments. We further reported that Health Service had failed to monitor and track supplemental rebate payments. We estimated that Health Services had not collected roughly \$40 million in supplemental rebates owed to the State and the federal government. During the fiscal year 2002–03 budget process, Health Services received approval and hired four analysts as of February 2003 to help resolve these issues, although it had requested approval to increase its staff of analysts for almost the past five years. Between January 1991 and September 30, 2001, the amount of unresolved rebates grew to more than \$216 million, or 6 percent of the \$3.4 billion invoiced. State law requires that Health Services and manufacturers cooperate and make every effort to resolve rebate payment disputes within 90 days of the manufacturers notifying Health Services of a dispute in the calculation of the rebate payments. Health Services estimated that it could achieve a total of \$10.5 million in savings to the General Fund for fiscal years 2002–03 and 2003–04 by resolving some of these rebate disputes.

To ensure that it has sufficient staff to work with manufacturers to resolve disputed rebates promptly and achieve cost savings, we recommended that Health Services evaluate periodically the number of staff needed to resolve disputed rebates within 90 days.

***Health Services' Action: Pending.***

Health Services expects to expand its staff by filling analyst positions and one manager by the end of December. Health Services anticipates resolving the backlog of disputes by the end of fiscal year 2004–05.

**Finding #6: Health Services' AIDS Drug Assistance Program has not taken advantage of the new automated billing and tracking system.**

Unlike Health Services' Medi-Cal drug program, the AIDS Drug Assistance Program (ADAP) does not have access to a unit rebate amount based on confidential pricing information that would enable it to calculate and bill correctly the federal rebate

payments owed by manufacturers. Instead, the ADAP relies on manufacturers to calculate and remit the correct amounts and thus cannot ensure that it has received the full rebate amounts. In 1998, the Health Care Financing Administration, now the Centers for Medicare and Medicaid Services, published a federal register notice that provided the ADAPs in all states with an option to receive the same federal rebates as the Medicaid program and to encourage ADAP's to emulate the Medicaid model.

However, because ADAP does not have access to the unit rebate amount information from the center, it bills manufacturers for its federal rebates using an estimated unit rebate amount that may be inaccurate. Additionally, the manufacturers send the rebates to the ADAP, usually including the actual unit rebate amounts they used to calculate the federal rebate owed; however, ADAP cannot verify whether the amounts are correct. In fact, our comparison of the federal rebates received by the ADAP with those received by Medi-Cal for nine of 67 drugs we reviewed found that the ADAP's federal rebates were lower, even though the amounts should have been the same. For example, for one drug, the ADAP received a rebate for one quarter that was nearly \$125,000 less than the amount it would have received using Medi-Cal's unit rebate amount data for that drug for the same quarter.

The ADAP also does not use an automated system to track the billing and collection of manufacturers' federal rebates. Without an effective accounting system, the ADAP cannot ensure that it submits invoices to manufacturers and receive their federal rebate payments promptly. In fact, we found that the ADAP did not send 14 invoices totaling \$2.9 million to manufacturers for the first quarter of 2001 until October 18, 2002, or more than six months after the completion of the quarter. Consequently, the State does not have the use of those funds for other commitments and is not maximizing the amount of interest it would otherwise collect by depositing the rebates earlier. Additionally, we suggest that it would be prudent for the ADAP to assess and collect interest from manufacturers that do not remit their rebates promptly as does the Medi-Cal program.

We believe that it would benefit the ADAP to take advantage of Health Services' Rebate Accounting and Information System (RAIS) to invoice drug manufacturers and, when the RAIS achieves its projected capability, to calculate interest on amounts owed by manufacturers when they delay in submitting federal rebate payments. In fact, in a letter dated January 2001, the

director of the center urged state Medicaid directors to work with the ADAPs in their state to assist in the submission of federal rebate claims to manufacturers within the requirement of the drug pricing confidentiality provisions.

We recommended that Health Services should follow the center's guidance and ensure that the ADAP and Medi-Cal staff coordinate their activities for obtaining federal rebates by using the RAIS for invoicing its manufacturers. Furthermore, it should ensure that its ADAP emulates the Medicaid model by seeking legislation to assess and collect interest from manufacturers when they delay submitting federal rebates.

***Health Services' Action: Pending.***

Health Services indicated it plans to ensure that the ADAP and Medi-Cal staff work together to improve the invoicing and collection of ADAP's rebates, either through the use of RAIS or other processes. However, Health Services stated that it does not plan to seek legislation to assess and collect interest from manufacturers when they delay submitting federal rebates. Specifically, Health Services stated that ADAP has not experienced delays in collecting rebates from manufacturers of brand name drugs, which generate the greatest amount of rebates. ADAP has experienced delays in collecting rebates from manufacturers of generic drugs and Health Services plans to remove their drugs from its drug list rather than continuing to use resources to pursue small rebates.

**Finding #7: Health Services pays less for certain brand name drugs than it does for their generic counterparts, but it can improve its contracting process.**

Although the supplemental rebates that Health Services negotiates with brand name drug manufacturers generally ensure that Medi-Cal incurs lower costs for drugs than do other state programs, Health Services does not have procedures to ensure that it accurately tracks the expiration dates of its supplemental rebate contracts and thus has ample time to renegotiate contracts. Our review of Health Services' drug prices found that it restricts its reimbursement to eight brand name drugs because it is generally able to obtain lower net costs for them than for their generic counterparts after applying the supplemental rebates it receives from the manufacturers. However, for the other two drugs we found that the net costs of the brand names were higher than those of the generics because Health Services failed either

to renegotiate the contracts or to secure critical contract terms from the manufacturer—errors that we estimated cost Medi-Cal roughly \$57,000 in 2002.

Currently, Health Services maintains a database that lists each supplemental rebate contract's terms, effective date, and expiration date. However, Health Services does not have a review process in place to ensure staff have entered all contracts appropriately into this database or its RAIS used for invoicing purposes. Further, although Health Services can run ad hoc reports to determine when its contracts will expire, it does not have a process to ensure that it follows up on and renegotiates contracts before the expiration dates. Until Health Services establishes such processes, it cannot ensure that it invoices all manufacturers at the correct amount. Moreover, it cannot ensure that it renegotiates or renews contracts before the expiration dates and runs the risk of continuing to allow pharmacies to dispense more costly drugs.

To ensure it obtains the lowest net cost for drugs, we recommended that Health Services should do the following:

- Establish policies and procedures to ensure that it follows up on and renegotiates supplemental contracts before their expiration dates. Further, it should establish a review process to ensure supplemental rebate contracts are appropriately entered into its contract tracking database and RAIS.
- If it is unable to complete negotiations for state supplemental rebates before contracts expire, it should immediately instruct EDS to remove the restriction on brand name drugs to allow pharmacies to dispense less expensive generic drugs without requiring TAR approval.
- Ensure that it secures written assurance from the drug manufacturer for all agreements made during a negotiation and includes this information in the terms and conditions of the contract.

***Health Services' Action: Partial corrective action taken.***

Health Services stated that it has temporarily redirected pharmacists from other functions, in addition to hiring four pharmacists, to renew and complete new contracts. Health Services also indicated that it has established a review process to ensure that supplemental rebates are appropriately entered into its contract tracking database and RAIS.

Additionally, Health Services noted that if it is unable to complete negotiation for state supplemental rebates, it plans to remove the restriction to allow the use of generic drugs when there is a net cost savings to the State. Furthermore, it has begun evaluating the net cost impact of removing the restrictions to use brand name drugs on a case-by-case basis.

Finally, Health Services stated it will ensure that all terms and conditions are delineated in the supplemental rebate contracts with manufacturers.

**Finding #8: Health Services could save \$20 million annually by placing the responsibility on the pharmacists to recover copayments.**

Federal law allows states to establish copayments; however, it does not allow states to assess charges for certain services, such as emergency services and services provided to any beneficiary under age 18. Additionally, it does not allow states to deny care to any beneficiary unable to afford the copayment. State law allows each participating pharmacy to retain the \$1 copayment it collects from each Medi-Cal beneficiary filling a prescription. Further, the beneficiary remains liable to the pharmacy for any unpaid copayments. Health Services could not provide us with an analysis of the pharmacies' collection rates for copayments, but it believes their collection rates are low.

At least one state, however, has taken a more aggressive approach toward collecting copayments from beneficiaries. Montana instituted copayments so that beneficiaries could share in the cost of their medical care, thus allowing it to reduce the cost to the state. Montana deducts the copayments from the pharmacies' reimbursements, placing the responsibility of collecting copayments on the providers. Health Services estimates that if implemented, by deducting the copayment from the pharmacy reimbursement rate, it would save Medi-Cal more than \$20 million annually, after adjusting for beneficiaries who are exempt.

We recommended that Health Services evaluate the pros and cons of deducting copayments from its reimbursement rate and having pharmacies collect these payments from beneficiaries. The evaluation should include, at a minimum, an analysis of costs, benefits, and pharmacies' collection rates.

***Health Services' Action: None.***

Health Services indicated that the 2003–04 Budget Act includes a 5 percent reimbursement reduction for pharmacies effective January 1, 2004. Health Services believes that this reduction will allow for greater annual savings than deducting copayments from its reimbursement rate and having pharmacists collect the payments from beneficiaries. Additionally, Health Services stated that an analysis of the costs, benefits, and pharmacy collection rates would likely require it to hire a contractor to conduct a survey of pharmacies, which would require a budget augmentation to pay for the contract.

**Finding #9: Drug alerts requiring TAR approval may prove to be an effective cost control.**

Two steps Health Services could take to possibly realize cost savings are adopting “duration of therapy” and “step therapy protocol” edits in its drug utilization review (DUR) program—a mechanism to ensure that prescriptions for covered outpatient drugs are appropriate, medically necessary, and not likely to have adverse medical effects. In 2000, the secretary of the Health and Human Services Agency established a task force to explore drug use and cost control strategies in the Medi-Cal program. One issue discussed by the task force was the possibility of having Health Services reestablish a hard edit for duration of therapy to control the use of certain drugs that become unnecessary or inappropriate after a specified period—for example, drugs prescribed for specific medical conditions, such as ulcers. In the past, Health Services used a hard edit for duration of therapy but decided to discontinue its use because of the substantial increase in the volume of TARs that its staff had to process as a result of the edit. However, Health Services could not provide us with data to support its claim that the volume of TARs that staff had to process increased substantially because of that particular hard edit. Additionally, task force participants supporting the reestablishment of the edit believed that it would prevent unnecessary prescription refills, reduce inappropriate therapies for certain medical conditions, and possibly reduce costs.

Another hard edit that might be useful in controlling drug costs would require a physician to prescribe a less expensive but therapeutically equivalent drug for a beneficiary who is in the early stages of a particular medical condition. This type of hard edit, called step therapy protocols or accepted treatment

guidelines, would recommend starting treatment of a condition with a less expensive drug that has a verified equivalent effect and moving on to a more expensive drug only if the patient is not responding to the first drug. Health Services told us that it had previously considered implementing step therapy protocols, however, it was unable to provide us with data or an analysis evaluating the costs and benefits of altering its process to include step therapy protocols. However, one state that responded to our survey reported that it has achieved cost savings totaling more than \$3.1 million for 9,600 claims by implementing step therapy protocols.

To achieve additional savings in its Medi-Cal pharmacy program, we recommended that Health Services should do the following:

- Measure the effect that the use of the duration-of-therapy hard edit has on its workload. If feasible, consider reestablishing this edit for additional savings.
- Evaluate its ability to adapt its prospective DUR program by using other types of hard edits, including step therapy protocols for specific drugs or classes of drugs. The evaluation should include an analysis of the costs and benefits associated with these approaches.

***Health Services' Action: Pending.***

Health Services stated that it has experienced delays in implementing duration of therapy hard edits due to the loss of pharmacist staff at its fiscal intermediary. However, its fiscal intermediary has hired a pharmacist who is now training to perform this function. Finally, Health Services indicated it is evaluating a cost-containment proposal from its fiscal intermediary to install some additional hard edits in its claim payment system.

**Finding #10: Health Services' educational methods related to DUR are indirect and project oriented.**

Health Services' retrospective DUR process monitors drug use and cost trends to identify misuses and educational needs. Through this process, Health Services has identified and developed responses to costly Medi-Cal drug patterns. Currently, Health Services' educational program disseminates information only to general audiences periodically and comprises a small number of active and proposed projects that are heavily

dependent on the expertise and resources of its DUR board members. Consequently, efforts to educate providers about inappropriate or medically unnecessary drug therapies, and the potential to capture cost savings that may result from changes in drug prescribing and dispensing behavior, are limited.

Specifically, in contrast to Medicaid programs in some other states we surveyed, Health Services does not promote education that emerges from the retrospective DUR program by sending "Dear Dr." letters to physicians and pharmacists (providers). Instead, Health Services told us that the use of Dear Dr. letters to providers for DUR education would be very difficult to implement and administer in California because of the large number of Medi-Cal beneficiaries and providers. However, we question this assertion. Although it may not be feasible to send Dear Dr. letters to all Medi-Cal drug providers, Health Services can, as do Medicaid programs in other states, use profiling to identify providers whose practices indicate that are most in need of intervention and send letters only to them.

In addition, Health Services' DUR board is responsible for identifying drug therapy problems and recommending the types of interventions that will most effectively improve the quality of drug therapy. In this capacity, it has recommended a number of educational projects. Most of the projects will ultimately implement direct educational interaction with prescribers in specific subject areas. The advantage of Health Services' approach is that it can rely on the expertise and resources of its voluntary DUR board members. However, Health Services' heavy reliance on the DUR board can also prove to be a potential weakness of DUR education. Health Services devotes only minimal resources to the board and the projects selected for development. However, because it lacks a formal plan outlining the goals, anticipated outcomes, and resource needs of the DUR educational program, we could not assess the adequacy of the resources it devotes to the DUR education program or what its future needs may be.

As we previously discussed, Health Services is already having difficulty hiring the pharmacists it needs. If it needs to expand its involvement in the DUR educational program, one approach it might consider is outsourcing some of those functions to a pharmacy school, as is done in other states, such as Oregon and Idaho. Health Services told us that it has considered contracting out some of its retrospective DUR and educational activities to a school of pharmacy; however, it has not conducted an evaluation of the costs and benefits of outsourcing these functions.

To improve its efforts to educate providers about inappropriate or medically unnecessary drug therapies and potentially capture additional cost savings, we recommended that Health Services should do the following:

- Reevaluate the cost-effectiveness of using Dear Dr. letters in a focused educational program that targets physicians and pharmacists, whose prescribing or dispensing practices are inappropriate.
- Work with the DUR board to develop a formal plan for its educational activities that includes at a minimum, the goals, anticipated outcomes, and resource needs. Further, Health Services should update the plan annually.
- If, in the future, it determines that it lacks adequate resources for its retrospective DUR and educational activities, it should evaluate the cost-effectiveness of outsourcing some of these functions.

***Health Services' Action: Pending.***

Health Services indicated that it is in the process of filling two research analyst positions created to determine the cost effectiveness of Dear Dr. letters and any other prescribing education efforts it undertakes as part of its drug expenditure reduction initiatives. Additionally, Health Services stated that it will develop prescriber profiles to create general documents for all prescribers and to facilitate its plans for peer-to-peer interaction.

**Finding #11: Despite working with other organizations on disease management, Health Services has not sought funding for the pilot projects.**

Although many states have implemented disease management programs, which are designed to improve the quality of care for Medicaid populations and ultimately contain costs for both prescription drugs and Medicaid overall, Health Services' progress toward a comprehensive disease management program is minimal. Recently, Health Services has collaborated with the California Pharmacists Association (CPhA) to develop Medi-Cal-specific pilot projects for disease management. The Medi-Cal Pharmacist Care Project was initially proposed in 2000 by the University of Southern California (USC) School of Pharmacy, in cooperation with the CPhA and Health Services, as an effort

to establish a framework wherein qualified pharmacists would serve as coordinators of disease management for high-risk Medi-Cal beneficiaries suffering from asthma and diabetes. A second proposal focusing on pharmacist services for hypertension was developed in 2002. The objectives of the proposals are to determine whether a pharmacist-coordinated model of disease management, applied to the Medi-Cal population, can improve health outcomes for beneficiaries.

However, Health Services lacks the funding it needs to begin the proposed pilot projects because it has relied on its nonprofit partners to secure funds. Consequently, until Health Services seeks funding to move forward on these pilot projects, the potential benefits of disease management programs and their applicability to the Medi-Cal population will remain unrealized.

We recommended that Health Services consider seeking funds to continue its collaboration with the CPhA and USC for the proposed pharmacist-coordinated disease management pilot projects. Then evaluate the results of the pilot projects and, if feasible, implement the models on a more widespread basis.

***Health Services' Action: Pending.***

Health Services indicated that CPhA recently received significant monetary commitments to fund a pilot project. Thus, CPhA is moving forward on a pilot project in the San Diego area that focuses on diabetes and, according to Health Services, one of its pharmacists is providing feedback to CPhA on the pilot project's design. Health Services stated that, if results are positive, it would take the appropriate steps to incorporate the project in the Medi-Cal program.

**Finding #12: Health Services may be able to achieve additional savings by reevaluating its policy regarding optional pharmacy benefits.**

Under federal law, states are allowed to exclude several therapeutic classifications from reimbursement in their pharmacy benefit programs. Health Services made a policy decision to include five of these optional classes of drugs as part of its pharmacy benefit: anorexia, weight loss, or weight gain drugs; cough and cold drugs; smoking-cessation drugs; barbiturates; and benzodiazepines, which include antianxiety drugs. Health Services' data show that, had it excluded these classes of drugs from its pharmacy benefit, it might have saved the State nearly \$80 million during 2001.

Health Services justifies its spending for these optional services with its belief that these drugs are keeping overall drug costs down. According to Health Services, if it did not cover these drug classes—in particular, the cough and cold drugs—its beneficiaries would demand prescription drugs from their physicians to relieve their symptoms, thereby creating a shift to higher-priced drugs that are not optional. Additionally, Health Services told us that other costs, such as Medi-Cal hospitalization costs, might increase because without the optional drugs, some beneficiaries might ultimately require hospitalization. However, Health Services could not provide us with an analysis to support the net effect that discontinuing to offer the optional drug class would have on increasing drug and hospitalization costs for certain beneficiaries. After conducting such an analysis, Health Service might be able to limit cough and cold drugs to beneficiaries who have asthma or are elderly, and similarly limit or eliminate other categories.

We recommended that Health Services conduct a study to identify the effect of discontinuing all or a portion of the optional drug therapeutic classifications from its benefits on Medi-Cal beneficiaries and Medi-Cal's drug costs. If it determines it is cost-effective to do so, Health Services should discontinue some or all of the optional drug classifications.

***Health Services' Action: Pending.***

Health Services stated that before discontinuing all or a portion of the optional drug therapeutic classifications, it must consider the health care consequences and costs in other parts of the Medi-Cal program that could occur with the removal of these drugs. Health Services indicated that it is currently reviewing all of its options.



# DEPARTMENT OF SOCIAL SERVICES

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## ***Continuing Weaknesses in the Department's Community Care Licensing Programs May Put the Health and Safety of Vulnerable Clients at Risk***

REPORT NUMBER 2002-114, AUGUST 2003

Department of Social Services' response as of October 2003

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### ***Audit Highlights . . .***

*As the State's agency for licensing and monitoring community care facilities, the Department of Social Services:*

- Has been less prompt in communicating exemption decisions.*
  - Has not adequately managed or investigated subsequent criminal history reports.*
  - Did not always follow its complaint procedures or make certain that facilities fully corrected identified deficiencies.*
  - Has adequately reviewed the counties it contracts with to license foster family homes, but has not always corrected identified deficiencies.*
  - Was not always timely, consistent, and thorough in its enforcement of legal decisions.*
- 

The Joint Legislative Audit Committee requested that we assess the Department of Social Services' (department) policies and practices for licensing and monitoring community care facilities. Since our last review in August 2000 (child care report), the department has more selectively granted criminal history exemptions and has prioritized and quickly processed legal actions against facility licensees. However, the department could improve in other areas.

### **Finding #1: The caregiver background check bureau granted exemptions without considering all available information.**

The caregiver background check bureau (CBCB) did not sufficiently consider information other than convictions when reviewing five of the 45 approvals we examined. The department's evaluator manual instructs the CBCB staff to consider factors such as the age of a crime, a pattern of activity potentially harmful to clients, and compelling evidence to demonstrate rehabilitation. However, the CBCB did not always consider all these factors. For example, the CBCB ignored self-disclosed crimes not appearing on individuals' criminal history records (rap sheets) and accepted without question character references that appeared inadequate.

To ensure that criminal history exemptions are not granted to individuals who may pose a threat to the health and safety of clients in community care facilities, the department should:

- Make certain it has clear policies and procedures for granting criminal history exemptions.

- Ensure staff are trained on the types of information they should obtain and review when considering a criminal history exemption, such as clarifying self-disclosed crimes and vague character references.

***Department Action: Partial corrective action taken.***

The department reported that it agrees with these recommendations. It has drafted procedures related to exemption processing, trained its staff on these procedures in September 2003, and will release an updated procedures manual in November 2003. The department reported that rap sheet screening procedures, among others, have been finalized and it is training staff on this material.

**Finding #2: The CBCB often did not perform criminal history checks within established time frames.**

The CBCB's performance in promptly communicating to facilities and individuals the ultimate decisions on exemption requests worsened since we issued the child care report, despite the CBCB extending its time frames for decisions from 45 days to 60 days. In 20 of the 45 (44 percent) criminal history exemption approvals we examined, the CBCB did not meet its timeline in effect when the exemption decisions were made, even though there was nothing unusually complex about most of the cases. In July 2003, emergency regulations became effective that prohibit an individual from being in a licensed facility until the CBCB completes a criminal history review. This regulatory change addresses the concern that individuals with dangerous criminal backgrounds may begin work before the department has evaluated their criminal history. However, the CBCB's delays will also prevent individuals with less serious criminal histories from working until the CBCB completes its criminal history reviews. Thus, the CBCB's delays may impede a person's ability to work.

To process criminal history reviews as quickly as possible so that delays do not impede individuals' right to work or its licensed facilities' ability to operate efficiently, the department should work to make certain that staff meet established time frames for making exemption decisions as requested.

***Department Action: Partial corrective action taken.***

The department said that it was placing a higher priority on individuals with lesser crimes or infractions because this group represents the largest majority of workload and allows these individuals to be in a facility as quickly as possible. The department stated that individuals needing a standard exemption will take longer to process.

**Finding #3: The CBCB's quality control review of exemption decisions was not always effective.**

Although the CBCB performed quality control reviews of exemption analysts' processing of exemption requests, we had one or more concerns with six of 17 cases that were subject to the CBCB's quality control process, indicating further improvement is necessary. The CBCB's quality control process is designed to help ensure that the exemption analysts reached the proper decisions based on the available information, including, but not limited to, rap sheets. In addition, the CBCB requires the quality assurance reviewer to verify that exemption analysts properly complete departmental forms and correctly draft letters communicating the exemption decision to the appropriate people and entities. However, we found that the CBCB's quality assurance reviewers sometimes failed to question cases for which exemption analysts had recommended approval despite missing documents or vague disclosures.

The department should assess its quality control review process and ensure that these policies and procedures encompass a review of the key elements of the exemption decision process.

***Department Action: Partial corrective action taken.***

The department stated that it is modifying its quality control procedures and expects final procedures to be in place by the end of 2003.

**Finding #4: The department could better track and assess arrest-only information and better review criminal history information before issuing clearances.**

If the CBCB receives arrest-only information, which discloses arrests for crimes without convictions, the CBCB may refer the information to the department's Background Information Review Section (BIRS). The BIRS determines whether an investigation of the circumstances leading to the arrest is necessary.

We expected the BIRS to have a process in place that did the following:

- Recorded when a case was referred to the field for investigation.
- Tracked a case to ensure that an investigation took place.

However, when the BIRS initiated an investigation, it failed to effectively track cases to their conclusion and has no systematic follow-up on cases it referred to the field to ensure an investigation is completed. As a result, necessary investigations may not have been completed, potentially exposing clients in community care facilities to unfit caregivers.

In addition, the department's policies and procedures for processing and tracking arrest-only investigations are not always clear. For example, confusion exists about how field investigators are to report their recommendations on cases involving behavior that is considered "conduct inimical"—behavior so harmful or injurious, either in or out of a facility, that there may be a statutory basis to ban an individual from a licensed community care facility. It is clear that both the BIRS and licensing offices should be informed of the recommendation, but it is not clear if the field investigators are to inform the licensing offices directly, or indirectly, through the BIRS. Without clear communication to track the status of a case, it is possible that after determining that an individual is unfit to be a caregiver, the department would fail to take action to remove the individual.

If the arrest-only information reflects a crime the CBCB considers inconsequential, such as a vehicle code infraction, or if a field investigation initiated by the BIRS cannot develop sufficient information to legally exclude the individual, either unit will issue a criminal history clearance. In three of 25 cases

with arrest-only information we examined, the CBCB (two cases) and the BIRS (one case) inappropriately issued criminal history clearances to individuals who were actively involved in court-mandated diversion programs. In these three cases—two cases involving welfare fraud and perjury and one case involving possession of a controlled substance—the CBCB and the BIRS failed to follow department policy of seeking additional information to determine whether the individuals were satisfactorily meeting the court’s requirements. By clearing individuals currently participating in diversion programs, we believe that the CBCB and the BIRS risk ignoring important information that could be used to better protect clients in community care facilities.

So that investigations of arrest-only information are properly tracked and communicated, we recommended that the department:

- Develop a process for the BIRS to record when it refers a case for investigation and track a case to make certain that an investigation takes place.
- Make certain that policies and procedures are consistent and clear on where the responsibility lies for ensuring that the necessary action occurs upon an investigation’s completion.

We also recommended that the department review and enforce its arrest-only policies and procedures to ensure that it is issuing criminal history clearances only when appropriate to do so and properly train staff on these policies and procedures.

***Department Action: Corrective action taken.***

The department stated that it implemented a system that generates a listing of cases and the dates these cases are referred to the field for investigation. The department said the list will prompt its analysts to inquire about the status of case investigations. In addition, the department reported that it implemented procedures that clearly define the responsibilities for ensuring that an investigation has been completed and appropriate action taken. Finally, the department stated that it had implemented procedures that address clearance criteria for arrests and that all appropriate staff have been trained.

**Finding #5: The CBCB's handling of subsequent criminal history information was weak.**

The Department of Justice (Justice) sends the CBCB subsequent rap sheets (subraps) to notify the CBCB of crimes for which caregivers or others at a facility have been arrested or convicted after the CBCB conducts its initial criminal history review. However, significant problems exist in the way the CBCB processes subrap information it receives from Justice. For example, the CBCB did not have adequate procedures for tracking its handling of subraps and sometimes did not record when it had received them. By not tracking its process, the CBCB was unable to effectively monitor whether it promptly considered subraps to protect clients in community care facilities. Furthermore, the CBCB was slow to notify facilities when exemptions were needed based on conviction information in subraps and did not notify its licensing offices when individuals could no longer be present in facilities because they failed to respond to these notices. Because of these delays, the CBCB sometimes allowed individuals unfit to be caregivers to remain in that role.

To ensure the department can account for all subraps it receives and that it processes this information promptly, we recommended that the department develop and implement a policy for recording a subrap's receipt and train staff on this policy. In addition, upon receiving a subrap, the department should ensure that staff meet established timeframes for notifying individuals that they need an exemption.

So that the department's licensing staff have accurate information about who should or should not be in a facility, thereby helping to protect clients, the department should meet its established time frame for notifying licensing staff and facility owners/operators that an individual has not submitted a criminal history exemption request as necessary and may no longer be present in a facility.

***Department Action: Partial corrective action taken.***

The department said that it has modified its computer system to allow for better subrap tracking. In addition, the department reported that all policies, procedures, and training plans will be in place by January 2004. Moreover, the department stated that it has placed a higher priority on cases where individuals have received approval to work in a facility and are later arrested for certain crimes or are

convicted of a crime. Finally, the department reported that it is reassessing its work priorities in order to establish more realistic timeframes regarding exemption needed notices.

**Finding #6: Under the CBCB’s current criminal history review procedures, certain out-of-state crimes may go undetected.**

If an individual leaves a community care facility and returns to work within two years, the CBCB may not be aware of that individual’s complete criminal record for the two-year period. To meet the Health and Safety Code requirement that it maintain criminal record clearances for two years after a caregiver or adult nonclient resident is no longer in a facility, the CBCB receives subraps from Justice disclosing any in-state criminal activity over the two-year period. Department policy is to rely on these ongoing disclosures and not require a full criminal background check when these individuals return to work in a licensed facility. As a result, a caregiver or nonclient resident could leave a facility, be arrested or convicted of a crime outside of the State, which would not appear in Justice’s subraps, and then return to a facility within two years without the CBCB knowing about the criminal activity. Unlike Justice, according to the operations branch chief of the Community Care Licensing Division, the Federal Bureau of Investigation does not offer a subrap service. However, he acknowledged that the problem we outlined exists, and stated that the department would continue to look at the issue.

We recommended that the department assess its Federal Bureau of Investigation background check practices to ensure that it is fully aware of an individual’s criminal record should that individual have a two-year or less gap in employment in community care.

***Department Action: Pending.***



The department assessed its practices as we recommended, but reported that limited resources will prohibit it from requiring additional Federal Bureau of Investigation background checks for individuals who become disassociated from a facility and then return to work within two years.

**Finding #7: The department did not always follow required complaint procedures.**

The department asserts that most of the corrective actions it undertakes are identified through its complaint process rather than other facility evaluations. However, we found when licensing analysts (analysts) identified facilities' deficiencies during complaint investigations, they did not always ensure that caregivers complied with the corrective action plans. For 11 of the 33 substantiated complaints we reviewed, the department could not demonstrate that the facilities completely corrected the problems that prompted the complaints. By not following through to see that corrections are made, the department negates its efforts in investigating and substantiating complaints.

To protect clients' welfare, laws and procedures mandate certain time frames within which the department must initiate and follow through on complaint investigations, but the department did not always meet these timeframes. For example, our review of 75 complaints the department received in calendar years 2001 and 2002 identified 19 complaints for which the department made its initial facility visits beyond the 10-day requirement set by law. The visits ranged from two to 175 days late. Whenever the department delays an initial facility visit following receipt of a complaint, the department runs the risk of perpetuating a client's exposure to the alleged harmful conditions.

Finally, the department's policies specify that abuse complaints are a top priority and require analysts and supervisors to handle these complaints differently from routine complaint investigations because these complaints represent a serious threat to the clients' well-being. However, the department did not consistently follow these special procedures for the top-priority allegations among the 75 complaints we reviewed. For instance, the department did not refer two of 22 abuse complaints to the field investigators as required and did not send another three within the required time frame of eight working hours after receiving the complaint. When analysts do not refer or are slow to refer serious complaints to the field investigators, the analysts risk jeopardizing the expeditious handling of complaints and may affect the immediate safety of vulnerable clients.

To address the department's weaknesses in following required complaint procedures, we recommended that the department:

- Continue to emphasize complaint investigations over other duties and require supervisors to review evidence that facilities took corrective action before signing off on a complaint.
- Require analysts to begin investigating complaints within 10 days of receiving complaints.
- Ensure that analysts follow policies requiring them to refer to the investigations unit any serious allegation within eight hours of receipt.

***Department Action: Partial corrective action taken.***

In August 2003, the department reminded its licensing staff of the importance of conducting and completing complaint investigations in a timely manner through a Workload Prioritization memorandum. The department reported that it will require all supervisors to wait to sign off on complaints until all plans of correction are complete. The department cited its increasing emphasis on complaints and the concern that all corrections be completed for making this change. The department indicated it plans to change its evaluator manual to reflect the requirement that licensing field staff issue a citation within 10 days of receipt of the investigative findings.

**Finding #8: Certified family homes may have avoided correcting their deficiencies by changing certification from one foster family agency to another.**

The department is responsible for licensing foster family agencies—private nonprofit corporations that in turn certify adults (certified parents) to operate foster family homes (certified family homes). However, because the department does not require foster family agencies to request information about applicants' compliance histories, the opportunity exists for certified parents to avoid correcting identified deficiencies.

We recommended that the department require foster family agencies to ask each applicant whether he or she had uncorrected, substantiated complaints at any other foster family agency and to verify the accuracy of an applicant's statements with the applicant's immediate prior foster family agency.

***Department Action: Partial corrective action taken.***

The department reported that it is developing a self-assessment Technical Assistance Guide for foster family agencies and plans to finalize it by February 2004. In addition, the department stated that this guide will serve as the foundation for regulations that it will develop within a year.

**Finding #9: The department sometimes granted facility licenses based on incomplete applications and did not always perform required post-licensing visits.**

When making its decision to license a new facility, the department did not always demonstrate that it collects and considers all required information and documents that help ensure the safety of vulnerable clients, such as evidence that the applicant obtained the necessary health screening and client care training. For example, of the 54 licenses we reviewed that the department granted during 2001 and 2002, the department granted 12 licenses before the applicants met one or more of the necessary requirements. In addition, the department did not consistently conduct all necessary post-licensing evaluations or ensure that the visits it did perform were made within statutory timelines. Specifically, of the 54 licenses we reviewed, 44 required post-licensing visits. For 13 of these facilities, the department could not provide documentation that it had conducted the necessary post-licensing visits. Moreover, the department conducted post-licensing visits late for an additional 21 facilities.

To ensure that it issues licenses only to qualified individuals, we recommended that the department ensure that analysts follow the department's checklist in collecting and considering all required licensing information, including, but not limited to, health screening reports, administrator's certification, and necessary background checks.

We also recommended that the department conduct the necessary post-licensing evaluations within the required time frame to make certain that newly licensed caregivers are operating according to regulations.

***Department Action: Partial corrective action taken.***

The department reported that it completed reviews of its licensing processes for its four program areas and is developing plans to better assure that all information necessary to approve licenses is received and reviewed. In September 2003, the department issued a memo outlining its program focus in response to the fiscal year 2003–04 budget. The memo lists post-licensing evaluations as an important activity and introduces annual and sample visit protocols that will provide additional time for post-licensing visits.

**Finding #10: The department did not always evaluate staff performance or provide required staff training.**

To periodically monitor the quality of the most important aspects of an analyst's work, the department created its quality enhancement process (QEP) reviews. Although supervisors in the foster care program prepared and documented the necessary QEPs for the analysts we selected to review, supervisors in the adult and senior care programs at the licensing offices we visited did not. In fact, adult and senior care program supervisors did not complete nine of the 11 QEP reviews of analysts we selected for examination. Although the supervisor recalls preparing QEPs for the remaining two analysts, she could not provide documentation to support her assertion. We believe ongoing assessment of the analysts' performance is essential to ensure the analysts are effectively applying program policies.

The Health and Safety code sets out staff development and training requirements for all analysts so they have the skills necessary to properly carry out their duties. Although these requirements are designed to provide information analysts need to stay current with the demands of their jobs, of the 22 analysts we selected who required this level of training during fiscal year 2001–02, 20 had training hours that fell short of statutory requirements. Without the necessary ongoing training, we question whether analysts are prepared to effectively perform their duties.

We recommended that the department make certain that all licensing office supervisors conduct QEP reviews of their assigned analysts. In addition, we recommended that the department make available to analysts the necessary training and develop a method to track whether analysts are meeting statutory training requirements.

***Department Action: Partial corrective action taken.***



The department reported that it suspended its QEP evaluations in offices with severe staffing shortages and that it plans to reimplement these evaluations when staffing levels improve.

The department also stated that it had developed a new training database and instructed staff on its use. In addition, the department said it is developing a training need assessment tool to assist it in determining the specific needs of each licensing program.

**Finding #11: The department has adequately monitored county licensing functions, but did not always ensure counties promptly corrected deficiencies.**

As the department's agents for licensing and monitoring foster family homes within their geographical boundaries, contracted counties must follow related state law and department guidelines for implementing and enforcing rules and regulations pertaining to foster family homes. Although the department reviews the counties' licensing programs, it provides limited guidance regarding time frames to department staff performing the reviews, for preparing their reports, notifying counties about deficiencies, and to provide counties to correct deficiencies. Our analysis revealed that liaisons sometimes allowed a long time to elapse between the end of their reviews and the due date for the counties to submit their corrective action plans. Four counties we reviewed originally had between 120 days and 329 days after the end of the review to submit their plans, and the liaison granted extensions to the due dates for three of these. By not obtaining the counties' evidence of prompt corrective action, the department has limited the effectiveness of its county reviews and potentially allows counties to continue to operate improperly.

To help ensure that counties contracting with the department to license and monitor foster family homes adequately and promptly respond to complaints and enforce corrective actions, we recommended that the department establish reasonable time frames for liaisons to prepare reports resulting from reviews of the counties and to notify counties of the results of those reviews and for counties to submit and complete their corrective action plans.

***Department Action: Corrective action taken.***

The department said that it developed a formal policy with timeframes for liaisons to prepare reports and send notification of the review results to the affected county. In addition, the department developed standard timeframes for staff to utilize in developing corrective action plans. This policy went into effect October 1, 2003.

**Finding #12: Despite recent efforts to improve, the department could do more to oversee county criminal history exemptions.**

There are 42 counties that contract with the department to license foster family homes, and these counties perform background checks on potential caregivers and nonclient residents to ensure that people with serious criminal histories are not providing foster care or living in foster family homes. Contracted counties must submit exemption reports each quarter, but the department did not fully utilize the reports. The department has not provided its staff guidance on when to review the reports, what to look for when they perform their reviews, and when to follow up. We believe collecting and reviewing the exemption reports on a continuous basis allows the department to track criminal record information from all 42 counties and make certain it is aware of all their exemption processing.

We recommended that the department develop procedures to ensure that it promptly and consistently reviews quarterly reports on exemptions granted by each contracted county to help ensure that counties contracting with the department to license foster family homes are making reasonable decisions regarding criminal history exemptions.

***Department Action: None.***



In its response, the department stated that it has continually reviewed its quarterly county exemption reporting process with the counties and licensing supervisors. However, the department has not addressed the need for it to establish internal procedures to ensure the information the counties submit is promptly and consistently reviewed.

**Finding #13: By conducting follow-up visits, the department could have improved its enforcement of legal actions.**

Once the department signs a decision revoking a caregiver's license, excluding a caregiver or adult nonclient resident, or putting a caregiver on probation, the legal division is responsible for sending a copy of the decision to the applicable licensing office. The licensing office is then responsible for enforcing the legal actions. We reviewed 26 legal actions which resulted in a caregiver's probation, exclusion, or license revocation. In 11 instances the department either did not adhere to its follow-up procedures to ensure the caregivers complied with the terms of the probation, revocation, or exclusion, or did not document its actions. Specifically, in five cases, the department failed to follow up with the caregiver promptly and in two cases did not visit the caregiver at all. In the remaining four cases, the department did not document the actions it took to follow up on the legal decision that was made.

To improve its enforcement of legal actions, we recommended that the department conduct follow-up visits to ensure that enforcement actions against facilities are carried out and that it document its follow-up for enforcement of revocation and exclusion cases.

***Department Action: Corrective action taken.***

The department stated that in August and September 2003 it issued memos reemphasizing the importance of conducting required visits to facilities to enforce legal actions.

# DEPARTMENT OF HEALTH SERVICES

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## ***It Needs to Better Plan and Coordinate Its Medi-Cal Antifraud Activities***

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### ***Audit Highlights . . .***

*Our review of the Department of Health Services' (Health Services) activities to identify and reduce provider fraud in the California Medical Assistance Program (Medi-Cal) revealed the following:*

- Because it has not yet assessed the level of improper payments occurring in the Medi-Cal program and systematically evaluated the effectiveness of its antifraud efforts, Health Services cannot know whether its antifraud efforts are at appropriate levels and focused in the right areas.*
- Health Services has not clearly communicated roles and responsibilities and has not adequately coordinated antifraud activities both within Health Services and with other entities, which has contributed to some unnecessary work or ineffective antifraud efforts.*
- An updated agreement with the California Department of Justice could help Health Services better coordinate investigative efforts related to provider fraud.*

*continued on next page*

### **REPORT NUMBER 2003-112, DECEMBER 2003**

#### **Departments of Health Services' and Justice's responses as of December 2003**

The Joint Legislative Audit Committee (audit committee) asked us to review the Department of Health Services' (Health Services) reimbursement practices and the systems in place for identifying potential cases of fraud in the Medi-Cal program, with the aim of identifying gaps in California's efforts to combat fraud. Many of the concerns we report point to the lack of certain components of a model fraud control strategy to guide the various antifraud efforts for the Medi-Cal program. Specifically, we found:

#### **Finding #1: Health Services lacks some components of a model fraud control strategy.**

Although Health Services has received many additional staff positions and has established a variety of antifraud activities to combat Medi-Cal provider fraud, it lacks some components of a comprehensive strategy to guide and coordinate these activities to ensure that they are effective and efficient. Specifically, it has not yet developed an estimate of the overall extent of fraud in the Medi-Cal program. Without such an assessment, Health Services cannot be sure it is targeting the right level of resources to the areas of greatest fraud risk. The Legislature approved Health Services' 2003 budget proposal for an error rate study to assess the extent of improper payments in the Medi-Cal program, and Health Services is just beginning this assessment.

In addition, Health Services has not clearly designated who is responsible for implementing the Medi-Cal fraud control program. A model antifraud strategy involves a clear designation of responsibility for fraud control, which in turn requires someone or a team with authority over the functional components that implement the antifraud program. Although Audits

- ☑ *Because it lacks an individual or team with the responsibility and authority to ensure fraud control issues and recommendations are promptly addressed and implemented, some well-known problems may go uncorrected.*
  - ☑ *Health Services does not obtain sufficient information to identify and control the potential fraud unique to managed care.*
- 

and Investigations (audits and investigations) is the central coordination point for antifraud activities within Health Services, some antifraud efforts are located in other divisions and bureaus of Health Services or in other state departments over which audits and investigations has no authority. Thus, audits and investigations' designation as the central coordination point within Health Services does not completely fill the need for an individual or team that crosses departmental lines and is charged with the overall responsibility and authority for detecting and preventing Medi-Cal fraud.

Rather than measuring the impact of its efforts by the amount of reduction in fraud, Health Services measures its success by reference to unreliable savings and cost avoidance estimates. A component of a model antifraud strategy requires evaluating the impact of antifraud efforts on fraud both before and after implementation of the effort. However, Health Services measures its efforts by the achievement of goals established during the development of its savings and cost avoidance estimates. Although antifraud efforts offer savings, they also need to be measured against their effect on the overall fraud problem to determine whether the control activities should be adjusted.

Finally, Health Services does not currently have processes to ensure that each claim faces some risk of fraud review. According to Health Services, although its current claims processing system subjects each claim to certain edits and audits, it does not subject each claim to the potential for random selection and in-depth evaluation for the detection of potential fraud. The 2003 budget proposal included establishing a systematic process to randomly select claims for in-depth evaluation and this is one of the components the Legislature approved.

We recommended that Health Services develop a complete strategy to address the Medi-Cal fraud problem and guide its antifraud efforts. This should include adding the currently missing components of a model fraud control strategy, such as an annual assessment of the extent of fraud in the Medi-Cal program, an outline of the roles and responsibilities of and the coordination between Health Services and other entities, and a description of how Health Services will measure the performance of its antifraud efforts and evaluate whether adjustments are needed.

***Health Services' Action: Pending.***

Health Services stated that it is in the process of implementing the model fraud control strategies. It has received federal funding for evaluating and measuring payment accuracy and will develop plans for annual payment accuracy studies that will aid in allocating resources and evaluating fraud deterrence and detection efforts. Health Services also stated that it will document the roles and responsibilities of the various programs participating in antifraud efforts and will work with the Health and Human Services Agency to improve the coordination of antifraud activities with other departments under its authority.

**Finding #2: Health Services has not yet conducted routine and systematic measurements of the extent of fraud in the Medi-Cal program.**

Health Services has not systematically assessed the amount or nature of improper payments in the Medi-Cal program. Improper payments include any payment to an ineligible beneficiary, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for applicable discounts. Without this information, Health Services does not know whether it is overinvesting or underinvesting in its payment control system, or whether it is allocating resources in the appropriate areas.

The Legislature approved portions of Health Services' May 2003 budget proposal including an error rate study and random sampling of claims. Building upon its authorization to conduct an error rate study, in August 2003 Health Services applied to the federal Centers for Medicare and Medicaid Services to participate in its Payment Accuracy Measurement (PAM) project for fiscal year 2003–04. In its PAM proposal, Health Services stated that it would develop an audit program to accomplish certain objectives, including identifying improper payments, and a questionnaire to confirm that a beneficiary actually received the services claimed by the provider. However, until Health Services completes its audit program and procedures, it is premature to conclude on the adequacy of its approach to verify services with beneficiaries to estimate the level of fraudulent payments.

We recommended that Health Services establish appropriate claim review steps, such as verifying with beneficiaries the actual services rendered, to allow it to estimate the amount of fraud in the Medi-Cal program as part of its PAM study. We also recommended that it ensure the payment accuracy benchmark developed by the PAM model is reassessed by annually monitoring and updating its methodologies for measuring the amount of improper payments in the Medi-Cal program.

***Health Services' Action: Pending.***

Health Services reported that it will ensure an appropriate claim review step is included to verify with the beneficiary that actual services were rendered. It also plans to reassess monitoring and measurement methodologies annually.

**Finding #3: Health Services does not evaluate the effect on the extent of fraud of its antifraud activities and uses unreliable savings estimates.**

Health Services does not perform a cost-benefit analysis for each of its antifraud activities, nor does it use reliable savings estimates to justify its requests for additional antifraud positions. According to Health Services, it uses a form of cost-benefit analysis, using estimated savings or cost avoidance as the benefit, to make decisions regarding resource allocations. Health Services indicated that it looks at the costs and savings of its antifraud activities in the aggregate and not by specific activity because not all the fraud positions it received are directly involved in savings and cost avoidance activities. Although it acknowledged that it does not use a formal cost-benefit analysis, Health Services asserts that it performs an intuitive type of assessment.

Health Services computes a savings and cost avoidance chart (savings chart) to estimate the savings it expects to achieve from its antifraud activities in the current and budget year. Health Services also uses the savings chart to quantify the achievements of each of its antifraud activities in the prior year and as a management tool to allocate resources. Health Services used the savings chart it created in November 2002 to support its request for 315 new positions for antifraud activities in its May 2003 budget proposal, of which the Legislature ultimately approved 161.5 positions.

However, Health Services' November 2002 savings chart potentially overstates its estimated savings because of a flaw in the methodology it uses to calculate the savings. Health Services

calculates its savings and cost avoidance estimates for some categories by using the average 12-month paid claims history of providers who have been placed on administrative sanctions. Health Services assumes that 100 percent of the claims it paid during the prior 12-month period to those providers sanctioned in the current year would be savings in the budget year. However, it does not perform any additional analysis to determine what proportion of the sanctioned providers' paid claims was actually improper. We questioned the soundness of Health Services' methodology because even though the improper portion of the claim history would be potential savings, any legitimate claims submitted by the sanctioned provider could continue as a program cost for beneficiaries who would presumably receive health care services from another provider who would bill the program.

We recommended that Health Services perform cost-benefit analyses that measure the effect its antifraud activities have on reducing fraud. Additionally, it should continuously monitor the performance of these activities to ensure that they remain cost-effective.

***Health Services' Action: Pending.***

Health Services stated that through the use of enhanced data analysis software and relationships with its various contractors, it will develop a standard cost-benefit analysis methodology for each antifraud proposal.

**Finding #4: The provider enrollment process continues to need improvement.**

Health Services' Provider Enrollment Branch (enrollment branch) screens applications to ensure that the providers it enrolls are eligible to participate in the Medi-Cal program. This includes ensuring that all Medi-Cal providers have completed applications, disclosure statements, and agreements on file, to help it determine whether providers have any related financial and ownership interests that may give them the incentive to commit fraud or were previously convicted of health care fraud. It also must suspend those Medi-Cal providers whose licenses and certifications are not current or active. Although these activities are important first lines of defense in preventing fraudulent providers from participating in the Medi-Cal program, the enrollment branch is not fully performing either of these activities.

In our May 2002 report, *Department of Health Services: It Needs to Significantly Improve Its Management of the Medi-Cal Provider Enrollment Process*, Report 2001-129, we made a number of recommendations to improve the provider enrollment process. However, the enrollment branch has not fully implemented many of these recommendations. For example, we recommended that the enrollment branch use its Provider Enrollment Tracking System to ensure that it sends notifications to applicants at proper intervals. However, the enrollment branch still does not track whether it sends the required notifications to applicants, nor does it notify a provider when an application is sent to audits and investigations for secondary review.

New legislation that took effect on January 1, 2004, increases the importance of sending these notifications. If the enrollment branch does not notify applicants within 180 days of receiving their applications that their application has been denied, is incomplete, or that a secondary review is being conducted, it must grant the applicant provisional provider status for up to 12 months. Moreover, this new legislation requires these notifications for applications be received before May 1, 2003. As of September 29, 2003, the enrollment branch had 1,058 applications still open that it received before May 1, 2003. If the enrollment branch did not notify these applicants of its decision on or before January 1, 2004, it must grant them provisional provider status regardless of any ongoing review.

It is noteworthy that when the enrollment branch refers applications to audits and investigations for secondary review, the processing time typically extends well beyond 180 days. Because audits and investigations currently has about a six-month backlog, the first thing an analyst does when performing a preliminary desk review is contact the applicant to verify the current address and continued interest in applying to the program. The analyst also redoes some of the screening previously performed by the enrollment branch, such as checking to confirm that the applicant's license is valid, resulting in inefficiencies and further extending the time applicants are left waiting.

Health Services is unable to ensure that all provider applications are processed consistently and in conformity with federal and state program requirements. The enrollment branch reviews applications for certain provider types, such as physicians, pharmacies, clinical labs, suppliers of durable medical equipment, and nonemergency medical transportation. The enrollment

branch checks a variety of sources to confirm licensure, verify the information provided on the application, confirm that the applicant has not been placed on the Medicare list of excluded providers, and refers many applications to audits and investigations for further review. However, other divisions within Health Services and other departments responsible for reviewing certain types of provider applications and recommending provider enrollment do not conduct a similar review. Since different units and departments screen providers against different criteria, Health Services may be allowing ineligible individuals to participate as providers in the Medi-Cal program.

Health Services' procedures are not always effective to ensure that enrolled providers remain eligible to participate in the Medi-Cal program. Our review of 30 enrolled Medi-Cal providers that Health Services paid in fiscal year 2002–03 disclosed two with canceled licenses. Even though state law requires providers whose license, certificate, or approval has been revoked or is pending revocation to be automatically suspended from the Medi-Cal program effective on the same date the license was revoked or lost, as of August 2003, the provider numbers for both of these providers were being used to continue billing and receiving payment from the Medi-Cal program every month since the cancellations occurred. Our review of the 30 selected providers also found that, despite the fraud prevention capabilities these required disclosures and agreements provide, the enrollment branch did not always have the agreements and disclosures required by state and federal regulations. Two of the 30 provider files we reviewed did not contain disclosure statements, and Health Services could not locate agreements for 24 of these providers. The disclosure statements provide relevant information to ensure that the provider has not been convicted of a crime related to health care fraud, and that the provider does not have an incentive to commit fraud based on the financial and ownership interests disclosed. The provider agreements give Health Services a certification that the provider will abide by federal and state laws and regulations, will disclose all financial and ownership interests and criminal background, will agree to a background check and unannounced visit, and will agree not to commit fraud or abuse.

Our May 2002 audit recommended that the enrollment branch consider reenrolling all provider types. Reenrollment would improve the enrollment branch's ability to ensure that all providers have current licenses, disclosure statements, and agreements on file. Although the enrollment branch has begun

reenrolling certain provider types it has identified as high risk, it has not developed a strategy to reenroll all providers and does not have a process to periodically check the licensure of existing providers with state professional boards. Additionally, it has not completed an analysis to determine what resources it would need to reenroll all providers.

To improve the processing of provider applications, we recommended that Health Services complete its plan and related policies and procedures to process all applications or send appropriate notifications within 180 days, complete the workload analysis we recommended in our May 2002 audit report to assess the staffing needed to accommodate its application processing workload, and improve its coordination of efforts between the enrollment branch and audits and investigations to ensure that applications, as well as any appropriate notices, are processed within the timelines specified in laws and regulations.

To ensure that all provider applications are processed consistently within its divisions and branches and within other state departments, we recommended that Health Services ensure that all individual providers are subjected to the same screening process, regardless of which division within Health Services is responsible for initially processing the application. In addition, we recommended that Health Services work through the California Health and Human Services Agency to reach similar agreements with the other state departments approving Medi-Cal providers for participation in the program.

To ensure that all providers enrolled in the Medi-Cal program continue to be eligible to participate, we recommended that Health Services develop a plan for reenrolling all providers on a continuing basis; enforce laws permitting the deactivation of providers with canceled licenses or incomplete disclosures; and enforce its legal responsibility to deactivate provider numbers, such as when there is a known change of ownership. Further, we recommended that Health Services establish agreements with state professional licensing boards so that any changes in license status can be communicated to the enrollment branch for prompt updating of the Provider Master File.

***Health Services' Action: Pending.***

Health Services stated it has taken some steps to improve the processing of provider applications and has created a workgroup to establish a complete work plan for processing applications as required by the new legislation. It will also evaluate the internal workload study on application processing and finalize the analysis. With the addition of new staff to enhance antifraud efforts, Health Services noted that provider enrollment and audits and investigations began to develop closer working relationships, and cited various actions taken to improve communication and coordination. In addition, its programs will participate and coordinate internally, as well as with other departments, programs, and entities that perform similar enrollment functions with the aim of using consistent enrollment processing procedures. Finally, Health Services indicates that it is developing a plan to reenroll all providers, will improve its procedures to ensure that provider numbers are properly deactivated, and is working with professional licensing boards to obtain provider permit and licensing information that is timely and readily useable.

**Finding #5: The pre-checkwrite process could achieve more effective results.**

Health Services has a review process it calls pre-checkwrite that identifies and selects certain suspicious provider claims for further review from the weekly batch of claims approved for payment. Although the pre-checkwrite process appears effective in identifying suspicious providers, Health Services does not review all of the providers flagged as suspicious. Moreover, Health Services does not delay the payments associated with suspect provider claims pending completion of the field office review.

We reviewed 10 weekly pre-checkwrites, which identified a total of 88 providers with suspicious claims from which Health Services selected 47 for further review. At the time of our audit, 42 provider reviews had been completed, and 31, or 74 percent, of these had resulted in an administrative sanction and referral to the Investigations Branch (investigations branch) or to law enforcement agencies. According to Health Services, limited staffing precludes it from reviewing all suspicious providers. Health Services states that it must perform additional analysis to develop sufficient evidence and a basis for placing sanctions, including withholding a payment or placing utilization controls on providers.

However, when Health Services does not promptly complete its reviews and suspend payment of suspicious provider claims until it completes its on-site review, its pre-checkwrite process loses its potential effectiveness as a preventive fraud control measure. Health Services could use existing laws to suspend payments for claims that its risk assessment process identifies as potentially fraudulent or abusive and release them once a pre-checkwrite review verifies the legitimacy of the claim. Although laws generally require prompt payment, they make an exception for claims suspected of fraud or abuse and for claims that require additional evidence to establish their validity.

We recommended that Health Services consider expanding the number of suspicious providers it subjects to this process, prioritize field office reviews to focus on those claims or providers with the highest risk of abuse and fraud, and use the clean claim laws to suspend payments for suspicious claims undergoing field office review until it determines the legitimacy of the claim.

***Health Services' Action: Pending.***

Health Services stated that it received additional staffing in fiscal year 2003–04 to expand the number and timeliness of pre-checkwrite reviews. It also indicated it will work with its legal office to maximize the pre-checkwrite activities and develop criteria to suspend specific claims and hold checks until the review is complete.

**Finding #6: Health Services and the California Department of Justice have yet to fully coordinate their investigative efforts.**

Although Health Services is responsible for performing a preliminary investigation and referring all cases of suspected provider fraud to the California Department of Justice (Justice) for full investigation and prosecution, it does not refer cases as required. Moreover, Health Services and Justice have been slow in updating their agreement even though the agreement is required by federal regulations and could be structured to clarify and coordinate their roles and responsibilities and, thus, help prevent many of the communication and coordination problems we noted with the current investigations and referral processes.

Our comparison of fiscal year 2002–03 referrals of suspected provider fraud cases from Health Services' case-tracking system database to similar records from Justice's case-tracking system

database revealed that 63 (41 percent) of the 152 Health Services case referrals to Justice were late, incomplete, or never received. According to Justice, it did not include 60 of the 63 referrals in its database because they were incomplete when Justice received them or it received them close to the date of indictment by an assistant U.S. Attorney for the Eastern District of California (U.S. Attorney). For the remaining three cases, although Health Services asserts that it referred them to Justice, Health Services could not provide documentation that clearly demonstrates its referral of them. Our review of 14 investigation cases corroborated that Health Services' investigations branch referred cases to Justice late; Health Services referred 12 an average of nearly five months after the date it had evidence of suspected fraud.

Although Health Services acknowledged that referring cases to Justice after indictment by the U.S. Attorney is no longer its practice, according to the investigations branch, it investigates and refers cases to the U.S. Attorney because the U.S. Attorney indicts suspected providers and settles cases quickly. Justice, on the other hand, typically focuses on developing cases for trial to pursue sentences that it believes reflect the seriousness of the defendant's conduct. Although both approaches have merit, depending on the particular case, Health Services and Justice have not come to an agreement on when each approach is appropriate and who should make that determination.

Additionally, according to Health Services' investigations branch chief, because neither federal nor state laws provide a clear definition of what constitutes suspected fraud, the investigations branch can refer cases to Justice at varying points in the process, including before, during, or after it has met the reliable evidence standard. Admittedly, the law does not clearly define what constitutes suspected fraud, but Health Services and Justice should reach an agreement on what standard must be met to assist both agencies in coordinating their respective provider fraud investigation and prosecution efforts.

The agreement between Health Services and Justice that is required by federal regulations could help alleviate many of the current problems about when Health Services should refer cases to Justice. Over the last several years, Health Services and Justice have intermittently discussed an update of the existing 1988 agreement. However, these two entities have yet to complete negotiations for an update of this agreement or to define and coordinate their respective roles and responsibilities for investigating and prosecuting suspected cases of Medi-Cal provider fraud.

We recommended that Health Services promptly refer all cases of suspected provider fraud to Justice as required by law and that both Health Services and Justice complete their negotiations for a current agreement. The agreement should clearly communicate each agency's respective roles and responsibilities to coordinate their efforts, provide definitions of what a preliminary investigation entails and when a case of suspected provider fraud would be considered ready for referral to Justice.

To ensure that Health Services and Justice promptly complete their negotiations for a current agreement, we recommended that the Legislature consider requiring both agencies to report the status of the required agreement during budget hearings.

***Health Services' Action: Pending.***

Health Services stated that a draft agreement would be finalized soon. It further indicated that it clarified the need to make timely referrals to Justice in its policy and procedures.

***Justice Action: Pending.***

Justice stated that both agencies are working quickly and in good faith to establish an agreement that will serve to strengthen the working partnership between the two agencies.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

**Finding #7: A more effective feedback process could strengthen Health Services' antifraud efforts.**

Although audits and investigations is responsible for coordinating the various antifraud activities within Health Services, its line of authority does not extend beyond audits and investigations. What is lacking is an individual or team with the responsibility and corresponding authority to ensure that worthwhile antifraud recommendations are tracked, followed up, and implemented. Such an individual or team would provide Health Services' management with information about the status of the various projects and measures that are under way, to ensure that antifraud proposals, including those involving external entities, are addressed promptly.

Without an individual or team with the responsibility and corresponding authority to follow up and act on recommendations for strengthening its antifraud efforts, some antifraud coordination issues or detected fraud control vulnerabilities may continue to go uncorrected. For example, although Health Services' provider enrollment process is the first line of defense to prevent abusive providers from entering the Medi-Cal program, the provider enrollment process continues to need improvement. Similarly, another unresolved fraud control coordination issue is the lack of an updated agreement between Health Services and Justice related to the investigation and referral of suspected provider fraud cases. Although laws make each of these state agencies responsible for certain aspects of investigating and prosecuting cases of suspected provider fraud, the current case referral practices result in a fragmented rather than a cohesive and coordinated antifraud effort. Both agencies indicate that they have made some efforts to update their 1988 agreement, but they have yet to complete negotiations for a current agreement that spells out each agency's respective roles and responsibilities.

We recommended that Health Services consider working through the California Health and Human Services Agency to establish and maintain an antifraud clearinghouse with staff dedicated to documenting and tracking information about current statewide fraud issues, proposed solutions, and ongoing projects, including assigning an individual or team with the responsibility and corresponding authority to follow up and promptly act on recommendations to strengthen Medi-Cal fraud control weaknesses.

***Health Services' Action: Pending.***

Health Services recognizes the contribution a clearinghouse can potentially make and will work with the California Health and Human Services Agency to more fully explore this recommendation and different approaches for its implementation.

**Finding #8: Health Services needs to give proper attention to potential fraud unique to managed care.**

In addition to its fee-for-service program, Health Services also provides Medi-Cal services through a managed care system. Under this system, the State pays managed care plans monthly fees, called capitation payments, to provide beneficiaries with health care services. Although fraud perpetrated by providers and beneficiaries, similar to what occurs under the fee-for-service

system, can also occur, another type of fraud unique to managed care involves the unwarranted delay in, reduction in, or denial of care to beneficiaries by a managed care plan.

Because of incomplete survey results and its concerns about the reliability of encounter data, which are records of services provided, Health Services does not have sufficient information to identify managed care contractors that do not promptly provide needed health care. In addition, Health Services does not require its managed care plans to estimate the level of improper payments within their provider networks to assure they are appropriately controlling their fraud problems and not significantly affecting the calculation of future capitated rates.

We recommended that Health Services work with its external quality review organization to determine what additional measures are needed to obtain individual scores for managed care plans in the areas of getting needed care and getting that care promptly, complete its assessment on how it can use encounter data from the managed care plans to monitor plan performance and identify areas where it should conduct more focused studies to investigate potential plan deficiencies, and consider requiring each managed care plan to estimate the level of improper payments within its Medi-Cal expenditure data.

***Health Services' Action: Pending.***

Health Services stated that its new contracted vendor should be able to gather data to address the inadequacies found in the surveys. It is also assessing how it can use managed care plan data to help target areas for focused monitoring. Health Services will consult internally and with outside entities on the feasibility of implementing through appropriate contract language the requirement that managed care plans estimate the level of improper payments within their Medi-Cal expenditure data.

# CALIFORNIA'S WORKERS' COMPENSATION PROGRAM

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## ***The Medical Payment System Does Not Adequately Control the Costs to Employers to Treat Injured Workers or Allow for Adequate Monitoring of System Costs and Patient Care***

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### ***Audit Highlights . . .***

*Our review of the workers' compensation medical payments system revealed that:*

- Rising medical costs are contributing to the increasing costs of the workers' compensation system—costs California's employers are required to pay.*
- Despite numerous warnings from research experts, the Division of Workers' Compensation (division) has done little to respond to the problems in the workers' compensation medical payment system.*
- Fee schedules intended to control the amounts paid for medical services and products are outdated or nonexistent. The medical payment system lacks enforceable treatment guidelines that can help contain medical costs and streamline the delivery of medical care to injured workers. Researchers point to inadequate control over treatment utilization as a primary cause of escalating costs in the workers' compensation system.*

*continued on next page*

**REPORT NUMBER 2003-108.1, AUGUST 2003**

**Division of Workers' Compensation, Department of Industrial Relations' response as of January 2004**

**T**he Joint Legislative Audit Committee requested that we review the medical costs related to the workers' compensation insurance system and the extent to which the payment structure has resulted in unacceptably high reimbursement rates.

### **Finding #1: Workers' compensation medical costs are rising because the medical payment system has not been well maintained or fully developed.**

The costs of the State's workers' compensation program to employers are spiraling upward, and numerous studies point to the rising medical costs of treating injured workers as a major contributor to the problem. The Workers' Compensation Insurance Rating Bureau (rating bureau) reported that the average total estimated medical cost per workers' compensation claim involving lost work time increased by 254 percent from 1992 to 2002. The insurance premiums charged to employers to provide workers' compensation coverage increased from \$5.8 billion to \$14.7 billion between 1995 and 2002.

The medical costs of the workers' compensation system are rising in part because the State has not taken the necessary steps to ensure that the costs of treating injured workers are within reasonable limits. The administrative director of the Department of Industrial Relations' (Industrial Relations) Division of Workers' Compensation (division) is responsible for administering and monitoring the workers' compensation

- ☑ *Although the division could adopt fee schedules developed by other entities, such as Medicare, it would first have to decide on how to adjust those fee schedules to best meet the needs of the workers' compensation system.*
  - ☑ *The division lacks a data collection system that allows it to monitor medical costs and measure the effectiveness of reforms made to the system.*
- 

system. However, the administrative director has not maintained or fully developed the medical payment system. Despite mandates to biennially update the medical fee schedules for professional services, inpatient hospital facilities, and for medical products—such as pharmaceuticals and durable medical equipment—other than for minor adjustments, these schedules have not been updated since 1999, and they are essentially a patchwork of prior fee schedules.

In addition, costs for services performed at facilities such as outpatient surgical centers and emergency rooms are not covered by fee schedules but are paid on the basis of what are known as usual, customary, and reasonable charges for such services. Health care experts consider this basis for payment to be inflationary, and thus these charges may be contributing to the escalating costs in the workers' compensation system.

Numerous studies have pointed to opportunities to improve cost control in the system; however, the division has not built upon those studies to implement corrective actions. The division's administrative director states that the division has not been able to dedicate more effort to improving the medical payment system due in part to staff reductions, indicating that he has lost almost 17 percent of his authorized positions and 19 percent of his filled positions since fiscal year 1999–2000. He added that when he was appointed in 1999, he was instructed to place a greater priority on improving the workers' compensation judicial process.

Further, the Legislature and administration have sometimes responded to the needs of the system with measures that impede improvement, such as requiring the use of data not currently being collected to develop a new fee schedule for outpatient surgical facility charges and reducing the funding for tasks critical to improving cost control.

Because rising medical costs in workers' compensation contribute to increased costs to California's employers, we recommended that greater importance should be placed on more closely managing the costs of providing medical care to injured workers. As such, the administrative director should take the steps necessary to identify the organization and level of resources needed to effectively administer the workers' compensation medical payment system and should work with the Department of Finance and the Legislature to obtain those resources. In addition, as part of an effort to more closely manage the

medical payment system, the administrative director should more aggressively pursue corrective action needed to address issues identified in research reports, such as those from the Commission on Health and Safety and Workers Compensation (commission), the Industrial Medical Council (medical council), the California Workers' Compensation Institute, and the Workers' Compensation Research Institute, as well as any issues raised by internal studies conducted by Industrial Relations.

We further recommended that to ensure future legislation does not contain any unintended impediments to the improvement of the workers' compensation system, the administrative director should be proactive in working with the Legislature to identify and amend any provisions that would adversely affect the administrative director's ability to effect changes.

***Industrial Relations' Action: Partial corrective action taken.***

Industrial Relations believes that the enactment of Senate Bill 228 (Chapter 639, Statutes of 2003) should reduce the resources needed to adopt fee schedules. It reports that the division is currently reviewing its resources and assessing what specific expertise is needed.

Although Industrial Relations responded that the governor's proposal to further reform the workers' compensation system will address concerns from stakeholder groups and research organizations, its response does not address how it will more aggressively respond to issues raised by researchers and experts in the field that we describe in our report.

Industrial Relations reports that the Labor and Workforce Development Agency (agency) and the division worked very closely with the Legislature and the Governor's Office on the proposals that were included in the 2003 reform and are currently assisting the Governor's Office in developing and reviewing legislative proposals to build on existing reforms.

***Legislative Action: Legislation proposed.***

Conference committee convened.

**Finding #2: A lack of effective utilization controls leads to higher medical costs.**

The workers' compensation payment system lacks a process that would allow doctors to use a uniform set of treatment guidelines as a standard for treating similar workplace injuries and illnesses.

Medical treatment guidelines that provide standards for the treatment reasonably required to relieve the effects of workers' injuries, and that are presumed correct unless medical opinion establishes the need for a departure from those guidelines, can serve to ensure that injured workers receive the care they need to return to work, control medical costs, and increase the efficiency of the delivery of those medical services. Researchers point to inadequate controls over treatment utilization as a primary cause of escalating costs in the workers' compensation system. Overall, they report that in the area of professional medical services, California's average payment amount per claim is typical of other states, but the number of treatments per claim provided to injured workers is far above the average.

Despite the research pointing out the absence of utilization controls, California's system is without an effective process that would make treatment utilization review standards consistent among insurers. As a result, according to a study conducted by the division, there is little consistency in the processes or criteria used by insurers and claims administrators to determine the necessity of treatments proposed by physicians. In fact, one-third of the claims administrators included in the study reported using more than one set of criteria but did not provide a methodology for selecting which one they used for a particular case.

The medical council has developed treatment guidelines and it recently voted to review the medical evidence on treatment and utilization and to update its guidelines. However, the law requires that the medical council be made up of members of the medical community that would be subject to the treatment guidelines and maintain liaisons with the medical, osteopathic, psychological, and podiatric professions. As such, we question whether the medical council is the entity that can most effectively develop treatment guidelines without giving the appearance that it could be influenced by the extent to which the guidelines might adversely affect the financial interests of the medical community.

We recommended that the administrative director, in coordination with the medical council, should adopt a standardized set of treatment utilization guidelines, based on clinical evidence, to deter over- or underutilization of physician services and other professional medical services and products. The administrative director should consider, to the extent possible, adopting treatment guidelines that are developed by independent entities and that are

updated with adequate frequency to reflect advancing technology and changes in professional practice. If the administrative director adopts treatment guidelines developed by the medical council, he should take the steps necessary to ensure that those guidelines are developed without the appearance of undue influence from any group that participates in the State's workers' compensation system.

***Industrial Relations' Action: Partial corrective action taken.***

Industrial Relations points out the reforms in Chapter 639, Statutes of 2003, effective January 1, 2004, requires the division to adopt a medical utilization schedule by December 1, 2004, but did not state when it would update such a schedule. It further states that the new reforms eliminated the medical council, thereby making moot the recommendation to consult with it on treatment utilization guidelines.

Industrial Relations states that the commission (an independent entity) will survey and evaluate existing medical treatment utilization standards and that it expects the commission's findings and recommendations by July 1, 2004. Industrial Relations states that until December 1, 2004, the most recent update of the American College of Occupational and Environmental Medicine Occupational Medical Practice Guidelines are presumed to be correct in determining the extent and scope of medical treatment.

**Finding #3: The current legal and regulatory structure for utilization control is ineffective.**

A primary cause of the lack of effective utilization controls is that under the current law, utilization reviews are usually not admissible as evidence in judicial proceedings to resolve disputes between medical providers and claims administrators. To be admissible as evidence, a decision reached through a utilization review would need to be supported by a report from a physician performing an examination of the injured worker—a level of review not typically used by insurers and claims administrators when approving payment for treatment. Therefore, utilization reviews prepared by claims administrators have no weight in judicial proceedings.

In addition, the law requires that the administrative director adopt model utilization protocols in order to provide utilization review standards and requires insurers and claims administrators

to comply with those protocols. However, the regulations adopted by the former administrative director do not establish utilization review standards based on utilization protocols but instead allow insurers to establish their own unique utilization review plans as long as they meet certain administrative requirements. We believe that the regulations fail to achieve the objective of using utilization reviews to contain medical costs. However, the administrative director stated that he does not believe he has the statutory authority to make utilization reviews mandatory for insurers.

The absence of an effective utilization control process leads to disagreements between medical providers and claims administrators over proposed treatments for injured workers. However, the system does not have an effective process for resolving those disputes. Under the current dispute resolution structure, unresolved disagreements are finally settled by the Workers' Compensation Appeals Board after going through the judicial process within the workers' compensation system. Lacking a more efficient intermediary process, nearly 20 percent of the workers' compensation cases end up going through this judicial process. This lengthy process of resolving disputes can prolong the duration of workers' compensation cases.

To ensure that the treatment guidelines can serve as an authoritative standard for the treatment of workers' injuries, we recommended that the administrative director should seek the changes necessary in the Labor Code to ensure that all insurers and claims administrators are required to follow the standardized treatment guidelines and that treatment guidelines are accepted for use in judicial proceedings.

In addition, after obtaining any needed amendments to the law the administrative director should amend the division's regulations to reflect those changes to the law. Specifically, the division's regulations should require that insurers and claims administrators adhere to the standardized treatment guidelines and should clearly define the role of treatment guidelines in determining treatment and in judicial proceedings.

***Industrial Relations' Action: Pending.***

Industrial Relations stated that the new reforms provide that upon adoption by the administrative director of a medical utilization schedule, the schedule shall be presumptively correct on the issue of extent and scope of medical treatment. According to Industrial Relations, the new law will ensure that insurers and claims administrators follow the treatment guidelines in the schedule, and that the guidelines are accepted in judicial proceedings.

Industrial Relations also states that the division is in the process of drafting new utilization review regulations to implement the new reforms.

***Legislative Action: Legislation proposed.***

Conference committee convened.

**Finding #4: Proposed changes to the medical payment system may control fees for medical services and products but do not ensure lower overall medical costs or access to quality care.**

The administrative director and the commission have presented two different proposals for improving medical cost controls using variations of Medicare-based fee schedules. The Medicare payment system for physician services is founded on a valuation of the resources needed to provide each service. This system is known as the resource-based relative value scale (RBRVS) system.

Basing part or all of the workers' compensation system on the Medicare RBRVS system would have several advantages, among them the values on which payments are based would be derived from the amount of resources needed to perform services, rather than on customary charges. In addition, Medicare updates its schedules regularly, and so the values would remain current. Health policy experts believe resource-based systems to be less inflationary than charge-based ones. However, because the payments are resource based, it is projected that for some medical specialties, such as surgery and anesthesia, the payment amounts would be reduced from the traditional charge-based payments, and payments for evaluation and management services would be increased. This redistributive effect of the RBRVS system is a major point of controversy among providers of these affected medical specialties, in spite of the RBRVS system's ability to contain costs.

More work is needed to ensure that injured workers have access to quality care at reasonable costs to employers. If the State adopts a payment system that is based on indexed values, such as the RBRVS, it will need to determine how to adjust the RBRVS to arrive at payments that will meet this objective. There is no universal way to make these adjustments. Other states that have implemented a payment system based on the RBRVS have used a variety of approaches in adapting the system to fit their needs. Some considerations the State must weigh include the need to balance adequate access to care against overutilization and whether a transition strategy may be needed to mitigate the effects of the payment redistribution that would be caused by an RBRVS payment system.

We recommended that when determining the future structure of the workers' compensation medical payment system, the administrative director should consider the costs and practicalities of maintaining such a complex system and should give consideration to adopting a payment system that is based on models that are maintained by other entities, such as a variation of the RBRVS maintained by the federal Centers for Medicare and Medicaid Services, as he has done with his current proposal for modifying the physician fee schedule. If the administrative director decides to continue modifying the current workers' compensation payment system, he should consider pursuing a variety of activities, including the following:

- Continue his efforts to identify the adjustments needed to ensure that payments for services in the proposed modified physician fee schedule are high enough to encourage participation by physicians and other professionals in order to provide adequate access to care for injured workers.
- Seek the needed resources to develop and maintain fee schedules for the remaining medical services and products, such as outpatient surgical facilities, pharmaceuticals, emergency rooms, durable medical equipment, and home health care.

One proposal to improve California's workers' compensation payment system requires converting the entire system to a combination system that would use a variation of the Medicare payment system for medical services, facilities, and products, and the Medi-Cal payment system for pharmaceuticals. If this proposal is adopted, the administrative director should consider the following steps:

- Develop adjustments to the fee schedule for physician services and other professional services so as to mitigate any effects on access to care caused by adopting a resource-based relative value payment system that results in redistributing payment amounts away from medical specialties, such as surgery, and in increasing payments for evaluation and management services.
- Monitor the medical payment system to determine whether a reasonable standard of care can be achieved at the capped prices for services and products contained in the proposal.
- To fully benefit from adopting the Medi-Cal payment system for pharmaceuticals, in addition to adopting the Medi-Cal fee schedule, the administrative director should also study the feasibility of establishing a process to secure rebates from drug manufacturers like the supplemental rebates enjoyed by the Department of Health Services in its Medi-Cal pharmaceuticals purchase program.

Because there are no universally successful formulas for determining payments for medical services and products, we recommended that the administrative director should consult also with other states that have adopted Medicare-based payment systems and consider any measures they have employed to secure quality care at reasonable prices.

***Industrial Relations' Action: Pending.***

Industrial Relations reports it is taking the following steps to address the recommendations we made above:

- The reforms that took effect on January 1, 2004, revised the existing medical payment system by repealing the existing Official Medical Fee Schedule language and replacing it with provisions that require reimbursement of pharmaceuticals at 100 percent of the Medi-Cal rate; and that inpatient hospital services and outpatient surgeries that occur in either a hospital or ambulatory surgical center be reimbursed at no more than 120 percent of the relevant Medicare rate.
- To gauge access to care, the division's administrative director is preparing to contract with the University of California to conduct a study of injured workers' access to medical treatment. The initial study is to be conducted in 2004 using funding from existing resources.

- Industrial Relations believes that the legislative changes in Chapter 639, Statutes of 2003, should reduce the resources needed to adopt fee schedules. The division is currently reviewing its resources and assessing what specific expertise is needed. Since the hospital, outpatient, and pharmaceutical fee schedules are based on data already compiled by government entities outside the division, the resources required by the division for these fee schedules may be available within existing resources.
- The new reforms require that the existing Official Medical Fee Schedule for physician services be reduced by 5 percent and remain in effect until January 1, 2006, at which time the administrative director has the authority to adopt a new physician fee schedule.
- The reforms require the administrative director to contract for an independent annual study of access to medical treatment for injured workers. If it is found that access to quality health care or products is insufficient, the administrative director may make appropriate adjustments to medical and facilities' fee schedules.
- The division will study the feasibility of securing rebates from drug manufacturers for pharmaceuticals dispensed in workers' compensation cases. However, Industrial Relations notes that because workers' compensation in California is not designed as a single payer system, the division may be limited in its ability to negotiate lower pharmaceutical prices.
- Finally, Industrial Relations states that the division has been in contact with virtually all other states through the International Association of Industrial Accidents Boards and Commissions (IAIABC) and will consult with those states with Medicare-based payment systems.

**Finding #5: The division lacks a data collection system that is adequate to monitor the workers' compensation system.**

The division does not currently have a data collection system that will allow it to perform the necessary research to monitor the effect of policy decisions on the quality and availability of care to injured workers. Although legislation that took effect in 1993 mandated the development of a data collection system,

the Workers' Compensation Information System (WCIS) is still incomplete. According to the division, intense opposition to data collection from insurers, a shortage of knowledgeable and experienced staff, and technical difficulties in installing the proper hardware and software infrastructure have delayed the implementation of the WCIS. The division still has not identified a projected completion date for the system.

The WCIS consists of three components: two are used to collect information on the nature and duration of workplace injuries, and the third collects data on medical treatments and payments. The first two components are complete and operational, but the division is still working to identify the types of medical data it needs to collect to provide useful information for monitoring the performance of the medical payment system. However, the division has not provided us with any assurance that the medical data it collects will generate the information required to meet the statutory objectives for the system. According to the administrative director, identification of the needed medical data has been slow due in part to the effort required to work through the concerns the insurers have about the cost of reporting the data.

Further, the division stated that, if its funding is stabilized by passage of a state budget that includes employer user fees or sufficient General Fund moneys, and if the proposed funding augmentation for Assembly Bill 749 is made, it will identify a timeline for completing the medical data collection module of the WCIS expansion. The 2003–04 Budget Act includes both employer user fees and an augmentation to fund Assembly Bill 749 mandates.

Now that the division's budget contains employer user fees and a spending augmentation the administrative director asserts is needed to complete the division's WCIS, we recommended that the administrative director should place the WCIS implementation project on a timeline to facilitate its completion as quickly as possible. In addition, the administrative director should exercise the authority necessary to ensure that the data collected in the WCIS will provide the information needed to adequately monitor medical costs and services.

***Industrial Relations' Action: Pending.***

Industrial Relations states that division staff is working closely with staff from the Information Systems Unit to design, develop, and implement a prototype model for medical data collection. The division developed a proposed list of medical data elements to be collected, based on IAIABC guidelines. The division plans to reduce the number of data elements, based on an analysis of the ability to collect each data element and its anticipated usefulness.

The major remaining obstacle to the ability of the WCIS to collect medical data elements is the cooperation of claims administrators, who may not be capturing the data elements the division believes necessary to adequately analyze medical treatment. Initial data has been received from the State Compensation Insurance Fund.

# STATE BAR OF CALIFORNIA

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## ***Although It Reasonably Sets and Manages Mandatory Fees, It Faces Potential Deficits in the Future and Needs to More Strictly Enforce Disciplinary Policies and Procedures***

REPORT NUMBER 2002-030, APRIL 2003

The State Bar of California response as of October 2003

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### ***Audit Highlights . . .***

*The State Bar of California (State Bar) continues to make some improvements since our audit in 2001. For example, it:*

- Made further changes to reduce its backlog of disciplinary cases.*
- Continued to ensure that mandatory fees are reasonable and do not support voluntary programs.*

*However, the State Bar needs to do the following:*

- Ensure that policies and procedures for processing disciplinary cases are being followed.*
  - Monitor its need for an increase in membership fees to avoid a potential deficit in its general fund in the future.*
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Chapter 342, Statutes of 1999, directed the State Bar of California (State Bar) to contract with the Bureau of State Audits to conduct a performance audit of the State Bar's operations from January 1, 2002, through December 31, 2002. We found that the State Bar continues to reduce its backlog of disciplinary cases that resulted from its virtual shutdown in 1998. Overall, the State Bar's efforts have significantly decreased the number of cases in its backlog from 1,340 at the end of 2000 to 401 at the end of 2002. In addition, the State Bar continues to ensure that dues for members are reasonable and are not used to support voluntary functions. However, deficiencies similar to those identified by the State Bar's staff in its 2000 internal random review of disciplinary cases continue to be an issue. Moreover, the State Bar's financial forecast indicates that if fees remain at its current level, the State Bar could face a deficit in its general fund at the end of 2005.

### **Finding #1: The State Bar has made significant progress in decreasing its backlog of disciplinary cases.**

Since our 2001 audit, the State Bar has continued its efforts to decrease its backlog of disciplinary cases. For example, it created a backlog team in its enforcement unit. The backlog team, composed generally of the most experienced investigators, focused exclusively on the backlog cases. The overall goal for 2002 was to have a backlog of no more than 400 cases. The State Bar's efforts significantly decreased the number of cases in its backlog from 1,340 at the end of 2000 to 401 at the end of 2002. According to a backlog reduction report prepared by its staff, the State Bar is currently focusing on not allowing the backlog to increase beyond 400 in 2003. Further, it maintains an "aspirational goal" of reducing the backlog to 250 by the end of

2003, but the report stated that the State Bar's ability to achieve that goal has been negatively impacted by budget constraints and other external factors.

We recommended that the State Bar continue its efforts to reduce its current backlog.

***State Bar Action: Partial corrective action taken.***

The State Bar reported that it is continuing its efforts to reduce the backlog. In June 2003, it reported that the backlog had risen to 756. However, as of October 2003 the State Bar reduced it to 566 cases. The State Bar stated it maintains its goal of bringing the backlog back down to 400 by the end of 2003.

**Finding #2: The State Bar needs to strictly enforce its policies and procedures when processing complaints.**

The State Bar's internal random review process indicates that staff do not always follow policies and procedures when processing complaints. Specifically, in 2002, the State Bar identified some of the same type of deficiencies as reported in its random review in 2000. Its two reviews in 2002 identified staff's failure to enter information into the computer database, poor record keeping and file maintenance, and not sending closing letters to complainants or respondents. Because State Bar staff did not always provide proper record keeping and file maintenance, the reviewers sometimes found it difficult to determine if a case had been appropriately handled. However, the reviewers found that the areas of concern were not generally significant enough to have an adverse effect on the overall disposition of a case. To address some of these issues, the State Bar conducted group and individual training, and it issued a training bulletin to remind staff of the policies and procedures.

We recommended that the State Bar require that each file contain a checklist of important steps in the process and potential documents to ensure that employees follow policies and procedures for processing cases. Each applicable item should be checked off as it is performed or received. An employee's supervisor should be responsible for reviewing the checklists to ensure their use. In addition, the State Bar should conduct spot checks of current cases that are being closed. Responsible staff should be required to resolve any issues concerning files determined to be noncompliant.

***State Bar Action: Partial corrective action taken.***

The State Bar reported that it has implemented the use of checklists to ensure important steps are taken and necessary documents are contained in the files. It also has begun implementation of a computer verification system. This system does not allow a matter to be closed or forwarded unless the file is properly updated. In addition, the State Bar reported that it has postponed until November 2003 the implementation of having supervising attorneys in the Office of the Chief Trial Counsel spot-check closures every month to verify that files include closing letters and detailed closing memos. Instead, the State Bar performed a one-time, large-scale audit of cases closed in 2002. A full analysis of the results was to have been completed by the end of October 2003.

**Finding #3: Cost recoveries for the State Bar's client security fund and disciplinary activities continue to be low.**

Since our 2001 audit, the State Bar's cost recovery rates improved slightly, although the rates remain low. Specifically, the Client Security Fund cost recovery rates increased from 2.5 percent in 2000 to 10.9 percent in 2002. A similar increase occurred in the cost recovery rates from the disciplinary process. In 2002, these amounts increased from 28.8 percent to 36.4 percent. Because cost recoveries are still low, the State Bar used more of its membership fees to subsidize support for its Client Security Fund and disciplinary process than it might otherwise need to.

The State Bar believes that other recovery methods, such as the State's offset program, may not be feasible. One cost recovery method that may be available is the collection of money debts under the California Enforcement of Judgments Law. However, according to the executive director, the State Bar's position is that state statutes explicitly define the specific circumstances and methods by which it is to impose and collect its disciplinary costs, and thus the Legislature has implicitly excluded other methods more generally provided in the law.

When our audit report was issued in April 2003, the executive director told us that the State Bar was seeking a legislative amendment, similar to statutory language applicable to costs imposed in disciplinary proceedings of the Department of Consumer Affairs, to help it strengthen its collection enforcement authority. Because existing state law does not

explicitly state that the State Bar can use the methods provided in the Enforcement of Judgments Law, the State Bar believes it needs statutory language that states it can do so. This language would provide the State Bar independent authority to pursue legal action for these costs.

We recommended that the State Bar pursue a legislative amendment that would help it strengthen its enforcement authority over collections related to client security and disciplinary costs.

***State Bar and Legislative Action: Corrective action taken.***

The State Bar reported that on September 6, 2003, the governor approved Assembly Bill 1708 (AB 1708). Effective January 1, 2004, sections 6086.10(a) and 6140.5(d) of the Business and Professions Code will provide that court orders, which impose disciplinary costs or require the reimbursement of the Client Security Fund by attorneys who have been suspended, disbarred, or the subject of a public reproof, will be enforceable as a money judgment. The remedy will apply retroactively to all court orders imposing disciplinary costs or Client Security Fund reimbursements. The State Bar reported that these changes would permit it to obtain writs and abstracts of judgments and seek orders of examinations in the superior courts. In addition, the recording of abstract judgments would then typically be reflected in the reports of credit agencies. Further, the State Bar reported that it created a working group of staff to establish the processes and procedures necessary to implement these new statutes on the effective date of January 1, 2004.

**Finding #4: Although it continues to ensure that mandatory fees are reasonable and do not support voluntary programs, the State Bar faces potential deficits in the future.**

For the year 2002, the State Bar's financial records for the general fund indicate that it charged a reasonable level of fees. The general fund's revenues of \$46.4 million exceeded its expenses by \$2.5 million. However, because the board of governors approved transfers to other funds of \$5.9 million, its general fund balance declined from \$6.6 million in 2001 to \$3.3 million in 2002. A financial forecast prepared by the State Bar predicts that in 2003 through 2007, if membership fees remain at \$390 a year, general fund expenses will exceed its revenues. Although the State Bar's general fund balance is

expected to decrease as a result of its expenses increasing faster than its revenues, a deficit is not expected to occur until the end of 2005 because of the newly created Public Protection Reserve Fund. As of January 1, 2001, the State Bar established this fund to provide a hedge against the unexpected and to assure continuity of its disciplinary system and other essential public protection programs. However, if State Bar expenses continue to exceed its revenues, a deficit in the combined available balance for the general fund and Public Protection Reserve Fund is anticipated by the end of 2005 that will continue to grow through 2007.

We recommended that the State Bar continue to monitor for the necessity of a fee increase to ensure that mandatory fees are set at a reasonable level to meet its operational needs.

***State Bar Action: Partial corrective action taken.***

In June 2003, the State Bar reported that because of the State's current fiscal situation it was seeking a one-year fee bill that would maintain mandatory dues at \$390 for the 2004 billing year. The State Bar expected to rely on existing reserves to balance the general fund budget for 2004 and anticipated proposing a multi-year fee bill with a tiered fee increase that would support ongoing operations without relying on reserves. In October 2003, the State Bar reported that the 2004 general fund budget was balanced by transferring the revenue allocated to the Lawyer Assistance Program back to the general fund; enhancing member revenue by restricting eligibility for reduced fees for certain categories of members (member fee scaling); eliminating the general fund contribution to the Public Protection Reserve Fund; eliminating 16 positions; and reducing proposed non-personnel expenditures. The State Bar also reported that AB 1708 was signed in September 2003, authorizing it to collect up to \$390 per member in annual membership fees for 2004. This authorization maintains the same fee level in effect since 2001. AB 1708 also amends existing statute to restrict eligibility for member fee scaling and allows the State Bar to enforce the collection of disciplinary costs incurred in the general fund and reimbursements to the Client Security Fund as money judgments to be included in an individual's membership fee. The State Bar is hopeful this legislation will provide additional funding and ease pressure to increase member fees. Finally, the State Bar reported that it would continue to review its operations for improvements in efficiency, with staff reductions, as appropriate.



# SAN DIEGO UNIFIED PORT DISTRICT

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## ***It Should Change Certain Practices to Better Protect the Public's Interests in Port-Managed Resources***

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### **Audit Highlights . . .**

*Although many San Diego Unified Port District (Port) actions we reviewed were in accordance with state law and Port policies, we noted the following exceptions:*

- The Port did not disclose that it offered below-market rental payments to one hotel, potentially lowering the Port's revenue by \$7.4 million over 10 years.*
  - For three major developments, the Port did not seek competition by issuing requests for proposals or qualifications.*
  - The Port's contracting practices sometimes do not ensure fair and open awards of its contracts and purchases.*
  - The Port lacks postemployment guidelines for its officials and often failed to meet its timelines for employee discipline appeals.*
  - The Port can improve its compliance with open meeting laws.*
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**REPORT NUMBER 2001-116, APRIL 2002**

**San Diego Unified Port District's response as of April 2003**

**T**he Joint Legislative Audit Committee requested that we review the San Diego Unified Port District's (Port's) contracting and personnel policies and procedures as well as the public's access to the Port's records and decision-making process.

### **Finding #1: The Port has not always done enough to seek fair market value in its leases.**

The Port earns some of its revenue by leasing the property it manages around the San Diego Bay (bay). Contrary to its leasing policies, when the Port signed a lease with one of its hotels in 1995, it granted a below-market rate for 10 years and did not disclose that it was doing so. The below-market rate may result in the Port receiving \$7.4 million less in rental payments over a 10-year period.

The Port may also be charging below-market rates to the marinas around the bay. When setting rental rates, the Port rejected rates suggested by an independent appraiser. Instead, the Port selected an appraisal methodology that did not consider rents paid by comparable properties, such as the City of San Diego's Mission Bay marinas. As a result of its decision to adopt a methodology that did not consider rates paid by nearby marinas, Port revenues between July 1999 and June 2001 were approximately \$600,000 lower than what they would have been had they used an alternative methodology.

We recommended that the Port obtain market value rent when awarding leases or disclose and provide appropriate justification for offering below-market rent when the Board of Port Commissioners (board) considers approval of the lease. We further recommended

that the Port consider adopting an appraisal methodology for its marinas that combines economic analysis with a review of rents paid on comparable properties.

***Port Action: Corrective action taken.***

The Port created an advisory committee to review the Port's proposed policies governing real estate leases and rentals. The board adopted the advisory committee's recommendation and instituted a policy that requires market value rent but the board retains the right to grant rent discounts, waivers, or other concessions. In addition, another adopted policy requires using appraisals that comply with the Uniform Standards or Professional Appraisal Practice to assist in determining market rent for new flat-rent leases and for rent reviews in existing leases.

**Finding #2: The Port pursued some major development projects without publicly soliciting proposals.**

The Port did not issue requests for proposals or qualifications on three major development projects and therefore may have missed opportunities to receive additional proposals from qualified developers. For one hotel development project, the Port chose to conduct a negotiating session over a holiday weekend, instead of issuing a request for proposals or qualifications. In another case, the Port received four unsolicited proposals to develop a hotel on Harbor Island but did not issue a request for proposals or qualifications to identify other interested parties. The Port also chose not to issue a request for proposals or qualifications for a third development project because it believed a tenant with a lease on an adjoining property would be best suited for the development. By not using a more open and competitive process for developing these projects, the Port has made itself vulnerable to claims that it has acted unfairly and not in the public's best interests.

We recommended that the Port solicit competition through requests for proposals or qualifications when developing major projects, unless there is a compelling public interest not to do so.

***Port Action: Corrective action taken.***

The Port agrees with our recommendation and has implemented a policy consistent with our recommendation.

**Finding #3: The Port's contracting practices do not always match its policies or follow best practices**

Some of the Port's actions in awarding contracts and making purchases have not been in line with best practices or its own policies. The Port amended two information technology contracts totaling more than \$1.7 million when significant changes in the scope of work indicated that the projects should have been bid separately and issued as separate contracts. Because it did not open this work to the competitive bidding process, the Port denied other consultants the opportunity to compete for these projects and has no assurance that it obtained the services at the best possible price and terms.

In addition, we found that the Port did not apply best practices in awarding the \$1.6 million contract because it allowed the consultants that had helped develop the requirements for the project to also bid on that project. Prudent practices would not allow consultants to bid on projects for which they had developed the requirements because it leaves the Port open to claims of favoritism and unfair competition.

In addition, because the purchasing department treated service contracts according to the approval rules for supply purchases, certain service purchase orders between \$50,000 and \$75,000 did not receive the board approval that Port policy required. The purchasing department was also failing to notify the board of service purchase orders between \$25,000 and \$50,000 as required by Port policy. Without board approval or notification, commissioners missed the opportunity to provide some oversight of these contracts or request additional information when they had questions.

We recommended that the Port competitively bid new contracts instead of amending existing contracts when the scope of work changes significantly. We also recommended that the Port adopt a policy that would prohibit contractors that have developed specific requirements for a project from subsequently bidding on that project. We further recommended that the Port follow its policy requiring board notification and approval of certain service purchases.

***Port Action: Corrective action taken.***

The Port agrees that it should bid new contracts instead of amending existing contracts when the scope of work changes significantly and is now reviewing each contract to ensure compliance. The Port has revised its policies to prohibit contractors that have developed specific requirements for a project from subsequently bidding on that project. Also, the Port reports that it is now complying with board policies concerning board involvement in approving contracts.

**Finding #4: The Port needs to better adhere to conflict-of-interest laws and may need to adopt additional guidelines.**

The Political Reform Act of 1974 requires that public officials disclose personal interests that might be affected while performing their duties and also requires that they disqualify themselves from any governmental decisions that would affect their financial interests. We found that one commissioner did not report real estate within two miles of the Port's jurisdiction as required by law. Although he corrected the error in his fiscal year 2001–02 disclosure statement, we believe that the Port's commissioners and employees required to file disclosure statements should reexamine their statements to ensure that they are complete and accurate.

Furthermore, although both the federal and state government have adopted post-employment guidelines for elected officials and government employees, the Port's conflict-of-interest policy does not include similar requirements for its officials. As a result, the Port has left itself open to claims that the actions of its exiting and former officials could constitute an improper influence on Port decisions. In particular, a former commissioner represented several clients in actions before the board less than a year after leaving the board.

We recommended that the Port encourage its commissioners and employees that file disclosure statements to review their current and past statements for completeness and accuracy. We further recommended that the Port consider adopting post-employment guidelines similar to those in place at the State and federal levels.

***Port Action: Corrective action taken.***

The Port has adopted a comprehensive ethics code that contains post-employment restrictions that are more restrictive than those of the Fair Political Practices Commission.

**Finding #5: The Port has not always followed its policies and procedures for appeals of personnel actions.**

The Port does not always conduct appeals of personnel actions as required in its rules and regulations. Based on our review of employees' appeals of disciplinary actions, we found that the Port almost always exceeds the time frames established in its appeal procedures. Because these procedures cause the Port's employees to have certain expectations about how the Port will act on disciplinary appeals, it is important for the Port's practices to match its policies.

We recommended that the Port ensure that personnel appeals are conducted according to Port procedures.

***Port Action: Corrective action taken.***

The Port has revised its policies and procedures to ensure that it either complies with timelines or documents employees' consent when extensions of time are granted.

**Finding #6: The Port can improve its compliance with open meeting laws.**

The Ralph M. Brown Act (Brown Act) states that a local legislative body may not take action or discuss any item that has not been publicly identified in the agenda or added by a vote of the body. However, in one instance, the board discussed an issue in closed session even though it had not given appropriate notice that the issue was being continued from a prior meeting. The impact on the public's access to the decision-making process was mitigated by the fact that the board did not act on this and one other issue at the meetings where they were discussed. In addition, we found three instances in which the Port's agenda descriptions for closed-session personnel discussions failed to provide sufficient information to meet the requirements of the Brown Act.

The Brown Act also allows local legislative bodies to recover their costs for providing agendas to individuals or groups that request an agenda be sent to them before each meeting. However, the Brown Act indicates that the fee charged cannot exceed the costs of providing the service. Yet the Port has not analyzed its costs for providing this service in over 10 years, even though it now faxes most agendas instead of mailing them. Without this analysis, the Port cannot ensure that the fees it charges for providing this service do not exceed the costs it incurs.

We recommended that the Port ensure it properly notifies the public of all board discussions, as required by state law. We further recommended that the Port reevaluate the fees it charges for distributing agendas to ensure the fees do not exceed the cost of distributing the agendas.

***Port Action: Corrective action taken.***

The Port agrees with the recommendation and has established additional procedures to ensure proper public notice of board discussions.

# RED LIGHT CAMERA PROGRAMS

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## ***Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level***

REPORT NUMBER 2001-125, JULY 2002

Audit responses as of July 2003 to September 2003<sup>1</sup>

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### *Audit Highlights . . .*

*Red light cameras have contributed to a reduction of accidents; however, our review of seven local governments found weaknesses in the way they are operating their programs that make them vulnerable to legal challenge. Specifically, we found that the local governments:*

- Need to more rigorously supervise vendors to maintain control of their programs.*
- All but one would use photographs as evidence in criminal proceedings even though it would appear to conflict with the law governing the program.*
- Generally follow required time intervals for yellow lights.*

*Of the local governments we visited, only San Diego and Oxnard have generated significant revenue from their red light camera programs.*

*Our review of available data shows that red light accident rates decreased between 3 percent and 21 percent after red light cameras were installed by five of the local governments in our sample.*

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The Joint Legislative Audit Committee (audit committee) asked us to review the implementation, application, and efficacy of red light camera programs statewide. We found that accidents related to motorists running red lights have generally decreased where local governments have employed cameras. However, the seven local governments we reviewed—Fremont, Oxnard, Los Angeles County (Los Angeles), Long Beach, the city of San Diego (San Diego), the city of Sacramento (Sacramento), and the city and county of San Francisco (San Francisco)—need to make operational improvements to maintain effective control of their programs, comply with state law, and avoid legal challenges.

### **Finding #1: Local governments have been challenged on their control of red light camera programs.**

Several local governments have been taken to court by alleged red light violators who claim that the local governments are not operating their red light camera programs as required under the law. Although the law stipulates that only a government agency, in cooperation with a law enforcement agency, can operate a program, it offers no further explanation or definition of what operate means, leaving the term open to interpretation. Because local governments contract out the bulk of services for these programs, private sector vendors inevitably play an important role. However, if municipalities delegate too much responsibility, they run the risk of their program being perceived as vendor controlled. For example, a court found that San Diego failed to satisfy the plain meaning of the word operate and that it had no

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<sup>1</sup> Each of the seven auditee's responses were received on the following dates: Los Angeles, Long Beach, San Diego, and Sacramento, July 2003; San Francisco and Fremont, August 2003; and Oxnard, September 2003.

involvement with or supervision over, the ongoing operation of the program and concluded that San Diego exhibited a lack of oversight. San Francisco is in the early stages of defending itself against a similar lawsuit. However, a court ruled in favor of Beverly Hills, which was also the subject of a lawsuit alleging concerns over program operations like those in San Diego.

We recommended that to ensure local governments maintain control and operate their red light camera programs and avoid legal challenge, the Legislature should consider clarifying the law to define the tasks that a local government must perform to operate a red light camera program and the tasks that can be delegated to a vendor.

***Legislative Action: None.***

No legislative action found.

**Finding #2: Local governments must more rigorously supervise vendors to retain program control.**

We found that the local governments we visited do not exercise enough oversight of their vendors to avoid the risk of legal challenge over who operates their red light camera programs. Best practices for oversight consists of several elements to monitor and control vendor activities. Such oversight includes strong provisions in local governments' contracts with vendors to protect the confidentiality of motorists' photographs and personal data, making periodic site visits to inspect the vendor's operations for compliance with the law and contract terms, establishing criteria for screening violations, having controls in place to ensure that the vendor only mails properly authorized and approved citations, making decisions as to how long certain confidential data should be retained, and conducting periodic technical inspections of red light camera intersections. However, at the outset of our review, we found that the seven local governments did not exhibit all of the oversight elements we believe are needed to avoid legal challenge. After our inquiries, Long Beach took steps to amend the contract with its vendor to address two elements of oversight that were absent.

To maintain control over their programs and minimize the risk of legal challenges, we recommended that local governments conduct more rigorous oversight of vendors by employing all of the oversight elements we identified.

***Local Government Action: Partial corrective action taken.***

The seven local governments for which this finding applied reported the following corrective actions:

➤ **Fremont:** Fremont reports that it now performs weekly spot checks of intersections with red light cameras. Further, Fremont completed a vendor site visit in April 2003, and concluded that the vendor maintains its office facility in an organized manner and is conducting business to the city's satisfaction. During this visit, Fremont concluded that the security over data was appropriate and that the vendor was purging Department of Motor Vehicles' records every 90 days. Fremont did not report action on our finding that its contract lacks a specific provision that makes the misuse of the photographs a breach of the contract.

**Long Beach:** Long Beach reports amending its vendor contract to specifically state that photographs are confidential and to include a provision on when to destroy confidential documents. Further, Long Beach reports implementing a procedure to reconcile citations it has approved against those that the vendor has mailed.

➤ **Los Angeles:** In August 2002, Los Angeles conducted an oversight visit of the vendor and it plans to perform other visits periodically. From this initial oversight visit, Los Angeles concluded that the internal controls are sufficient to maintain the integrity of the evidence and to ensure that only authorized citations are mailed to offending drivers. However, it will reevaluate the need for additional controls over the citation process when it awards a new vendor contract in December 2003. Los Angeles has developed new business rules that require the vendor to comply with all confidentiality provisions of the California Vehicle Code. The business rules also require that information and pictures for unenforced violations be destroyed immediately. The business rules will take effect when the county awards a new contract for red light camera services in December 2003. Recently, Los Angeles has adopted new maintenance procedures to inspect intersections equipped with red light cameras. The new procedures provide that at least once per quarter, or when signal timing is changed, the county's department of public works, red light camera vendor, and the California Highway Patrol will conduct a joint on-site test and certification to ensure that camera settings and calibration are correct.



**Oxnard:** Oxnard suspended its program in January 2003 and reports that it changed red light camera vendors, with the new vendor beginning to install cameras in September 2003. Under the new vendor contact, Oxnard reports that the vendor must adhere to the confidentiality provisions in law, with any violation constituting a breach of contract with the city. Although the new contract does not require that data and photographs relating to unenforced citations be destroyed immediately, the contract does require that the vendor adhere to the city's policy for records retention and destruction of confidential information. Oxnard also indicates that during an upcoming visit to the vendor's facility, police officers will review the vendor's procedures for compliance with the contract and the practices outlined in our report. Finally, Oxnard believes that the vendor's system allows for a remote confirmation of the calibration of red light cameras. However, Oxnard indicates that it will conduct periodic inspections of intersections to ensure systems are intact and report any problems to the vendor.



**Sacramento:** Sacramento reports restarting its program in October 2002 as a joint photo enforcement program with the Sacramento County Sheriff's Department (sheriff's department). In September 2003, the city plans to enter an agreement with the sheriff's department, which will essentially allow the county to operate the red light camera program in the city as a part of a countywide enforcement program. The city believes this agreement will standardize and centralize the program so that only one program, with one standard is in effect. The city will have input into camera locations, but the day-to-day operation, maintenance, inspections, and issuance of citations will become the responsibility of the sheriff's department. The city indicates that sheriff's department staff will perform the citation screening, processing, and mailing functions that the vendor previously performed. The vendor will continue to maintain the cameras, develop the film and convert it to digital images, and archive the film. However, Sacramento indicates that all photographs relating to unenforced citations will be retained for three years because the city attorney believes that such retention is necessary to comply with California Government Code, Section 34090, and a city council resolution. Also, although Sacramento County will operate the city's program, the city of Sacramento indicates that it does not intend to review the need for revising the

contract language to specifically protect the confidentiality of data and photographs obtained from the Department of Motor Vehicles until after the current vendor contract expires.

**San Diego:** San Diego indicates it has restarted the program using the same vendor and that it has made numerous changes that should significantly improve the city's oversight of the vendor. Specifically, the revised vendor contract adds provisions that specify the confidentiality of program data and increase the penalties for contract violations. In addition, the city has developed detailed business rules to guide the vendor's review process. The city's police department will also inspect the vendor's facility each week. These inspections will be documented and will review security and data handling, along with testing a sample of alleged violations for proper handling by the vendor. The city's police department and traffic engineering office will conduct periodic inspections of red light camera intersections to ensure that the system settings and original construction designs have not been altered or tampered with. Further, the city attorney's office developed issuing guidelines for the alleged violations that it deems are prosecutable and the police department has agreed to follow these guidelines. Although not directly related to vendor oversight, the city is now using dual cameras—one showing the front view and one showing the review view—to better show the vehicle approaching the intersection and continuing through it during the red light phase. Finally, San Diego has changed the payment structure to pay the vendor based on a fixed monthly fee for each intersection equipped with red light cameras.

**San Francisco:** San Francisco reports taking several actions to address our recommendations. It now conducts all team meetings at the vendor's facility and intends to inspect the vendor's facility to ensure that confidential information is being safeguarded. In addition, San Francisco has commenced inspections of red light camera intersections to ensure that camera settings are appropriate and to determine whether the system is functioning properly. Further, in June 2003, San Francisco indicates the police department reconciled authorized citations with those mailed to ensure that only authorized citations were mailed for the period between October 2002 and May 2003. This reconciliation found no errors or inconsistencies. Finally, it has amended the vendor contract to require the vendor to destroy all data related to unenforced violations.

**Finding #3: Most local governments believe photographs can be used for other law enforcement purposes.**

According to state law, photographs captured by red light cameras are to be used only for enforcing compliance with traffic signals. However, local governments have differing interpretations of the confidentiality of the photographs taken by red light cameras. Six of the seven local governments in our sample acknowledged that they have used or would use the photographs for purposes other than enforcing red light violations, such as investigating unrelated crimes. According to our legal counsel, a literal reading of the statute prohibits use of the photographs for purposes other than to prosecute motorists for running red lights. However, several jurisdictions believe that other laws, as well as the California Constitution, would permit the use of red light photographs as evidence in criminal proceedings. According to our legal counsel, in view of the conflicting interpretation of the law, the courts will ultimately decide whether local governments are violating the red light camera law when they use photographs in criminal investigations. The California Constitution also provides that with a two-thirds vote of its members, the Legislature can specifically exclude certain evidence from criminal proceedings, and according to our legal counsel, this would likely include photographs related to traffic signal enforcement.

Because a potential conflict exists between the confidentiality provision in the Vehicle Code and the California Constitution regarding the admissibility of evidence, we recommended that the Legislature consider clarifying the Vehicle Code to state whether photographs taken by red light cameras can be used for other law enforcement purposes.

***Legislative Action: None.***

No legislative action found.

**Finding #4: Local governments may not have addressed engineering improvements before installing red light cameras.**

Although we found that traffic safety was usually the reason for selecting intersections for red light camera enforcement, we could not always verify that local governments addressed engineering solutions before placing red light cameras at intersections. The Federal Highway Administration recommends that before installing a red light camera system, traffic engineers review the engineering aspects of the potential sites to determine

whether the problem of vehicles running red lights could be mitigated by engineering changes or improvements. San Francisco best demonstrated that it met this best practice, while the other local governments we visited conducted their engineering improvements on a more informal and ongoing basis.

We recommended that before installing red light cameras, local governments should first consider whether engineering measures, such as improving signal light visibility or using warning signs to alert motorists of an upcoming traffic signal, would improve traffic safety and be more effective in addressing red light violations.

***Local Government Action: Partial corrective action taken.***

The six local governments for which this finding applied reported the following corrective actions:



**Fremont:** Fremont has not reported the action it plans to take on this recommendation.

**Long Beach:** Long Beach reports that should it decide to expand the program beyond the three-year pilot, it will perform engineering reviews at each location identified for red light enforcement.



**Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.

**Oxnard:** Oxnard indicates that its traffic engineer has considered all possible options prior to installing red light cameras, including using an all-red interval to clear intersections, adjusting yellow light time intervals, adding new roadway striping, installing light-emitting diodes in signal lamps, and adjusting the posted speed limits. However, as noted in our audit, we could not determine if Oxnard took these steps before installing red light cameras under its original program.



**Sacramento:** Sacramento has not reported the action it plans to take on this recommendation.

**San Diego:** San Diego has developed selection criteria for intersections, and it indicates that a detailed list of engineering solutions will be first considered at intersections selected for enforcement before it restarts the red light camera program. Also, intersections selected for enforcement will have a one second all-red interval to allow vehicles in the intersection time to clear.

**Finding #5: Some local governments bypassed state-owned intersections with high accident rates.**

Caltrans allows red light cameras at state-owned intersections but requires an encroachment permit for construction. The time it takes to obtain an encroachment permit—which grants the local government access to a state right-of-way for construction—was viewed differently among the local governments we visited. Fremont and Long Beach avoided placing red light cameras at state-owned intersections because they anticipated that the Caltrans permitting process would be too cumbersome and would unnecessarily delay the start of their programs. San Diego stated that Caltrans was unwilling to allow red light cameras on state-owned intersections, but the city could not provide evidence of Caltrans’ refusal. Also, Los Angeles did not consider state-owned intersections for its program. By avoiding state-owned intersections, these local governments failed to place cameras at some of the more dangerous intersections within their jurisdictions.

To focus on traffic safety and to avoid overlooking high-accident locations that are state owned when considering where to place red light cameras, we recommended that local governments diligently pursue the required Caltrans permitting process, even though it may cause some delays to their programs.

***Local Government Action: Partial corrective action taken.***

The four local governments for which this finding applied reported the following corrective actions:

**Fremont:** Fremont reports that it will be pursuing the installation of red light cameras at state-owned intersections in the near future and that it has begun discussions with Caltrans regarding these installations.

**Long Beach:** Long Beach reports that should it decide to expand the program beyond the three-year pilot, it will consider placing red light cameras at state-owned intersections.

**Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.

**San Diego:** The city indicates that it will place red light cameras at state-owned intersections if those intersections meet the selection criteria, regardless of any potential delays.



**Finding #6: Not all local governments require vendors to follow municipal permit and engineering standards when installing red light cameras.**

Local standards may include issuing the proper permits to perform the work, reviewing engineering drawings and plans for the suitability of the work proposed, and inspecting the finished work for accuracy and adherence to the plans and local construction requirements. Six of the seven local governments we visited required vendors to follow local permit and engineering standards to ensure proper construction and inspection of red light camera systems. However, San Diego chose not to apply its local permitting and engineering standards to red light camera intersections. Specifically, San Diego did not ensure that plans were prepared by a registered civil or electrical engineer, nor was the construction subject to the city's formal plan check, permitting, and inspection procedures.

We recommended that to ensure that intersections are constructed and cameras are installed as planned, local governments should follow their own permit processes by reviewing the as-built plans and inspecting the intersection after construction.

***Local Government Action: Corrective action taken.***

The one local government for which this finding applied reported the following corrective action:

**San Diego:** San Diego indicates that it will follow its own permit process. Specifically, it will require that a registered engineer design and submit plans for each red light camera installation for review and approval. Further, a city inspector will inspect the construction of each site before it is placed in operation, and as-built plans will be prepared to illustrate the actual construction of each site.

**Finding #7: Caltrans guidance to local governments related to yellow light time intervals could be more specific.**

With few exceptions, the local governments we visited complied with a new law requiring that the minimum yellow light time interval at intersections with red light cameras meet the standards established by Caltrans. The law became effective January 1, 2002, and was prompted by the Legislature's concern that yellow light time intervals at such intersections may be shorter than Caltrans' standards. Caltrans' standards use the

speed of the approaching traffic to determine the appropriate time interval for a yellow light. However, the Caltrans traffic manual does not specify how traffic engineers are to determine the speed of the approaching traffic, which can be done in one of two ways: using the posted speed limit or surveying the traffic speed. Therefore, local governments that do not meet Caltrans' standards using both posted speeds and speed survey results run the risk that their yellow light time intervals may be legally challenged.

To avoid the risk of legal challenges, we recommended that local governments petition Caltrans to clarify its traffic manual to explain when local governments should use either posted speeds or the results from speed surveys to establish yellow light time intervals at intersections equipped with red light cameras.

***Local Government Action: Partial corrective action taken.***

The seven local governments for which this finding applied reported the following corrective actions:



**Fremont:** Fremont has not reported the action it plans to take on this recommendation.

**Long Beach:** Long Beach indicates that it sent a letter to Caltrans that specifically requested clarification on whether the yellow light time intervals at red light camera intersections should be based on engineering surveys. However, the city had not received a response as of July 2003.



**Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.

**Oxnard:** Oxnard indicates that its yellow light time intervals comply with accepted standards, but does not indicate whether it petitioned Caltrans to clarify the guidance in the Caltrans traffic manual.



**Sacramento:** Sacramento has not reported how it will address this recommendation.

**San Diego:** The city indicates that it has increased minimum yellow light time intervals to 3.9 seconds and 3.4 seconds, for a straight through movement and a left turn, respectively. City engineers will also review the approach speeds at red light camera intersections to ensure that the yellow light time intervals meet or exceed Caltrans' standards.

**San Francisco:** San Francisco reports that it intends to seek confirmation from Caltrans regarding its current practices for yellow light time intervals.

**Finding #8: Accounting for program revenues and expenditures is weak.**

Although good internal control practices dictate that local governments properly account for the revenues and expenditures of their respective red light camera program, only Fremont did so. Because each local government pays their respective vendor based on the number of red light citations that motorists' pay, it would be prudent for them to properly account for program revenues. Additionally, we found that only Fremont and Long Beach conduct monthly reconciliations of their vendors' invoices with the courts' payment records to ensure that they are paying their vendors the appropriate amount. Also, San Diego, San Francisco, and Oxnard could only provide us with estimates for some of their program costs. Without a more precise method of accounting for program expenditures, these local governments cannot accurately determine the cost-effectiveness of their programs and ensure that local resources are used appropriately.

To allow for better accountability over red light camera programs and to ensure that vendors are paid appropriately, we recommended that local governments improve their methods of tracking revenues and expenditures related to their programs.

***Local Government Action: Partial corrective action taken.***

The five local governments for which this finding applied reported the following corrective actions:



**Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.

**Oxnard:** Oxnard indicates that the city's accounting system now allows for the tracking of expenditures related to the red light camera program.

**Sacramento:** Sacramento indicates that it hopes the partnership with the Sacramento County Sheriff's Department will improve accountability over the program, but it does not indicate specific actions that will occur to implement this recommendation.

**San Diego:** San Diego's police department and courts have changed their accounting processes to allow for the accurate accounting of red light camera ticket revenues and expenses.

**San Francisco:** To more accurately calculate expenditures, San Francisco reports that it is looking into setting up an accounting procedure to track police effort on the program.

# LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY

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## Audit Highlights . . .

*Although it is too early to predict the success of the Los Angeles County Metropolitan Transportation Authority's (MTA) decentralization of its bus services into five service sectors, our review found the following:*

- The MTA did not perform any cost-benefit analyses or fiscal projections, nor did it fully consider alternatives to sectors before implementing them.*
  - Despite the MTA's limited analysis, we generally did not find negative effects associated with the MTA's decentralization of bus operations.*
  - The MTA lacks a way to determine cost savings and ridership data accurately at the sector level.*
  - The MTA could provide better training to governance councils in two areas that limit their ability to make service changes: the MTA's consent decree and union contracts.*
  - Weaknesses in the methods the MTA uses to advertise governance council meetings could cause it to miss opportunities to use these meetings effectively as a means of improving community input into bus operations and tailoring services to local needs.*
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## ***It Is Too Early to Predict Service Sector Success, but Opportunities for Improved Analysis and Communication Exist***

REPORT NUMBER 2002-116, DECEMBER 2003

Los Angeles County Metropolitan Transportation Authority response as of December 2003

The Joint Legislative Audit Committee (audit committee) requested that we review the Los Angeles County Metropolitan Transportation Authority's (MTA) decentralization of bus operations in the Los Angeles region into service sectors. The audit committee specifically requested that we assess the MTA's fiscal projections or cost-benefit analyses to determine whether service sectors will reduce or add costs. We also reviewed various issues related to service sectors, including the training that MTA provided to sector governance councils and the manner in which governance council meetings are advertised. Finally, the audit committee requested that we review the potential for overlapping services in those areas where municipalities provide transit services. We found the following:

### **Finding #1: The MTA did not perform extensive analysis and planning before establishing sectors.**

Before implementing service sectors, the MTA did not conduct any cost-benefit analyses or fiscal projections, nor did it fully consider alternatives to sectors. During the sector creation process, the MTA limited its analysis of the impacts of sectors on bus operations to a draft plan that it compiled in March 2002 detailing its vision and goals for service sectors. However, this plan lacked any financial analysis. Thus, before embarking on its sector implementation, the MTA did not develop any estimates as to what the costs of establishing and operating sectors would be and did not establish a baseline that it later could use to determine whether its actual costs met its expectations. The MTA's limited analysis in planning for sectors has reduced its ability to measure the effectiveness or efficiency of its sector implementation.

We recommended that the MTA ensure that it plans for future projects adequately by conducting sufficient analysis. Specifically, the MTA should consider conducting cost-benefit analyses, fiscal projections, and analyses of alternatives when implementing major changes or programs.

***MTA Action: Pending.***



The MTA's response to our report did not specifically address each recommendation. Instead, the MTA stated that it appreciates that our recommendations are aligned with its intent to continue to attain its objectives in facilitating community-based bus services.

**Finding #2: The MTA transferred some existing problems to the new service sectors' operations.**

The MTA transferred some existing problems to the new service sectors. Specifically, we found the following:

- The MTA has problems calculating actual amounts saved by sectors because the recorded costs of the service sectors do not include their divisions' use of some support functions. Specifically, the MTA does not allocate expenditures related to the divisions' use of the regional rebuild center, which performs heavy maintenance; the divisions' use of the bus operating control center; and the training provided by the operations central instruction department. Because the MTA does not allocate the costs of some support functions to the divisions using the services, the divisions' reported costs do not reflect the true expense of operating the divisions, so total expenditures are understated. MTA management cited a limitation in the MTA's information systems as the reason for not being able to allocate these costs. The MTA plans to create a new method for charging these costs to sectors by July 2004.
- The MTA's methodology for computing boarding data is not sufficient to allow it to provide accurate ridership data at the sector level. The MTA uses a sample methodology to calculate its ridership. This methodology is accurate when used to calculate total annual ridership for the MTA as a whole, but it becomes increasingly inaccurate and therefore meaningless for decision making when used to calculate ridership for smaller levels, such as sector ridership numbers, because the smaller levels are based on smaller sample sizes that do not yield statistically valid conclusions. Although the MTA is

implementing a new automated passenger count system that it plans to have fully in place by late 2004, the sector general managers currently lack accurate information on boardings and thus lack important feedback on how their decisions affect bus ridership.

We recommended that the MTA continue its efforts to track all costs associated with sector operations and to identify the actual savings generated. Further, we recommended that the MTA continue its efforts to improve its computation of boarding data.

***MTA Action: Pending.***



The MTA's response to our report did not specifically address each recommendation. Instead, the MTA stated that it appreciates that our recommendations are aligned with its intent to continue to attain its objectives in facilitating community-based bus services.

**Finding #3: The MTA has not communicated adequately with its governance councils regarding some pertinent issues.**

Although the MTA provided training to the governance councils on their various responsibilities, it has not communicated adequately with its governance councils regarding some pertinent issues. Specific areas our audit identified include the following:

- Some governance council members that we spoke with expressed their belief that the MTA should return cost savings to the sectors that generated the savings. However, the MTA has certain limitations that prevent it from calculating these savings, and it has not communicated these limitations to the various governance councils. Further, the MTA board of directors retains final authority for approving budgets, and it has not yet addressed the issue of where cost savings, once it becomes possible to calculate them, will be spent. Nonetheless, some sector general managers may have established erroneous expectations with their governance councils that the MTA at present cannot fulfill.
- The MTA provided limited training to governance councils in two areas that could limit the councils' ability to make service changes: the MTA's consent decree and union contracts. Under the MTA's consent decree, an agreement that the MTA entered into in response to a civil rights lawsuit brought by

various plaintiffs representing bus riders, the MTA must reduce load factors (the number of passengers in relation to the number of seats on its buses) to agreed-upon ratios by year. Governance council members could become frustrated if they attempt to make service changes that the MTA's headquarters subsequently overturns because of consent decree violations. Further, because of provisions in one union contract, governance councils face limitations in cutting some services if they expect municipal operators to pick up these lines.

We recommended that the MTA clearly define and communicate to the governance councils all the information they need to accomplish their goals, including information on limitations related to the MTA's problems in calculating actual sector savings, as well as information on the consent decree and union contracts.

***MTA Action: Pending.***



The MTA's response to our report did not specifically address each recommendation. Instead, the MTA stated that it appreciates that our recommendations are aligned with its intent to continue to attain its objectives in facilitating community-based bus services.

**Finding #4: Weaknesses exist in the methods the MTA uses to advertise governance council meetings.**

Weaknesses in the methods the MTA uses to advertise governance council meetings could result in it missing opportunities to use these meetings effectively to improve customer input into bus operations and to tailor service to local needs. Specifically, we found the following:

- The MTA does not run print advertisements of governance council meetings on a monthly basis, and does not have a regular schedule in which it publishes advertisements for governance council meetings. Therefore, the public does not have a predictable way of knowing when a governance council meeting is about to occur.
- The brochures that the MTA designed for specific sectors lack information on the times and dates of governance council meetings. Additionally, four monthly brochures the MTA issued in 2003 to communicate overall MTA news did

mention the governance council meeting times and dates. However, each brochure highlighted only a single council per month, even though other councils also met during this time.

- The MTA advertises its monthly governance council meetings in announcements added to the MTA's "Board Meetings/Agendas" section of the MTA Web site. Bus riders must know where to look for this information. The MTA's sector Web page contains general information about the sectors, and the MTA Web site has a page with links to bus line timetables. However, neither page provides links to the information about the monthly sector governance council meetings on the "Board Meetings/Agendas" page.
- The MTA displays sector information, such as a general sector overview and a map of the sector area, on its Web site, but it does not show the bus routes for which each sector is responsible. The MTA does not publish this information anywhere else, including in its bus route schedules or via posters on the vehicles. The only avenue the MTA currently provides bus riders to determine what sector is responsible for a given route is through its toll-free number for customer service (1-800-COMMUTE). However, the MTA does not publish the fact that bus riders can get sector-related information from staff members through this number.

We recommended that the MTA ensure that it uses appropriate and sufficient means of communicating to bus riders information on governance councils and sectors. For example, we recommended that the MTA consider adding information about bus routes and their corresponding sectors to its service sector and bus route Web pages, and it should consider adding information about its governance council meetings to these Web pages. Further, we recommended that the MTA consider adding information on governance council meeting times and locations to the brochures designed for specific sectors that it places on buses. It should also consider regularly advertising this information in newspapers.

***MTA Action: Pending.***



The MTA's response to our report did not specifically address each recommendation. Instead, the MTA stated that it appreciates that our recommendations are aligned with its intent to continue to attain its objectives in facilitating community-based bus services.

**Finding #5: The MTA needs to involve municipal transit operators in the formation of its new transportation system.**

The issue of duplicative service is a longstanding problem that predates service sectors, and the MTA plans to address this issue by comprehensively reorganizing bus services. The MTA expects to begin implementing a new hub-and-spoke network by December 2004 and to complete the process by June 2006. However, the MTA only recently started its planning efforts and has not yet invited municipal operators to participate directly in these initial planning and brainstorming stages. Although MTA staff stated the MTA delayed the planned implementation of the new network, in part to conduct more outreach with the municipal transit operators, the MTA's current efforts have been limited to making brief presentations at meetings that municipal operators have attended. If the MTA does not effectively introduce municipal operators' views by allowing them to participate directly, as opposed to the indirect process of simply collecting input, it risks formulating a plan that will not receive sufficient buy-in from municipal operators, which could be detrimental to the network's future success.

We recommended that the MTA continue its planned efforts to focus on eliminating duplicative routes to the extent possible. Specifically, we recommended that the MTA allow stakeholders, such as municipal transit operators, to participate directly in the planning process. If the MTA does not proceed with its restructuring plans, we recommended it create and implement policies and procedures to ensure that it coordinates service changes with municipal operators in such a way that it eliminates duplicative services to the extent possible.

***MTA Action: Pending.***



The MTA's response to our report did not specifically address each recommendation. Instead, the MTA stated that it appreciates that our recommendations are aligned with its intent to continue to attain its objectives in facilitating community-based bus services.

# CALIFORNIA DEPARTMENT OF CORRECTIONS

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## ***A Shortage of Correctional Officers, Along With Costly Labor Agreement Provisions, Raises Both Fiscal and Safety Concerns and Limits Management's Control***

REPORT NUMBER 2002-101, JULY 2002

California Department of Corrections' response as of August 2003

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### ***Audit Highlights . . .***

***Our review of the California Department of Corrections' (department) ongoing fiscal problems revealed:***

- A shortage of correctional officers continues to drive overtime costs higher.***
  - At its current pace of hiring, it may take the department until 2009 to meet its need for additional correctional officers.***
  - Some officers work excessive amounts of overtime while others at the same prison work very little overtime.***
  - Certain provisions in the labor agreement between the State and the California Correctional Peace Officers Association, related primarily to correctional officers, will eventually add about \$518 million to the department's annual costs.***
- 

The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct an audit of various Department of Corrections' (department) fiscal problems. The audit committee expressed particular interest in the collective bargaining process that governs the department's relationship with its correctional officers, the assignment of new cadets from the academy to prisons, the impact of statewide mandated salary savings on correctional officers' use of overtime and sick leave, and the impact of medical transportation costs on the cost of medical care.

### **Finding #1: The department pays large overtime costs to cover for unmet correctional officer need.**

The department has been unable to attract and train enough correctional officers to meet its needs. Specifically, as of September 2001, its full-time and intermittent officers numbered only 19,910 while its budget and labor agreement allow for a maximum of 23,160 officers. As a result, the department has an unmet need of about 3,250 officers. To fill this unmet need, the department has resorted to assigning overtime. During the first half of fiscal year 2001–02, the department spent more than \$110 million on custody staff overtime—already \$36 million more than its overtime budget of \$74 million for the entire fiscal year. We estimate that the department will not fill its unmet officer need until sometime between the end of 2005 and the beginning of 2009, depending on the number of future academy graduates and the officer attrition rate.

To reduce its use of overtime, the department should consider the feasibility of further increasing the number of correctional officer applicants and, if warranted, the physical capacity for training them. Additionally, the department should pursue additional funding from the Legislature to operate its academy at full capacity. Once it can attract more cadets to its academy, the department should pursue funding for additional correctional officer positions that it will need to reduce its reliance on overtime. Until such time, as the department has enough correctional officers to meet its needs and incurs only unavoidable overtime, the department should be realistic in its budget and plan for the overtime it will need to cover its unmet need. Finally, the department should maximize its use of intermittent officers by either converting them to full-time or ensuring that they work as close to the 2,000-hour-a-year maximum as possible.

***Department Action: Partial corrective action taken.***

The department states that as part of the fiscal year 2003–04 governor’s 20 percent reduction plan, it submitted a proposal to restructure the academy so that 12 weeks of training will be provided at the academy and the remaining four weeks of training will be provided at the cadets’ assigned institution. The department asserts that the authority for this change was contained in Senate Bill 19X and was signed into law by the governor in March 2003. However, implementation of the restructured academy is contingent upon the State and the union representing correctional officers reaching agreement on the implementation of the on-the-job training requirement. The department indicates that it is in negotiations with the union regarding this issue. The department believes that the reduced length of the academy will allow it to schedule an additional two classes per year, potentially graduating several hundred additional officers per year.

The department also states that it is pursuing authority and funding for additional correctional officer positions, and indicated that the use of sick leave by correctional officers continues to be a major contributor to overtime. In addition, the department stated that as part of its analysis of correctional officer needs through June 2005, it has developed procedures to project the overtime necessary to cover vacancies, and has incorporated this information into its fiscal year 2003–04 budget request. Further, the department indicated that its institutions maximize their use of intermittent officers by converting them to full-time when positions become vacant and if, or when, intermittent officers are eligible for and accept

permanent positions. Finally, the department reports that 193 intermittent officers were appointed to full-time positions during the period from January 1, 2003, to June 30, 2003.

**Finding #2: Savings from vacant budgeted positions are insufficient to finance shortfalls in the overall funding for correctional officers and overtime.**

The savings the department realizes by intentionally leaving more than 1,000 of its authorized correctional officer positions vacant under the Institutional Vacancy Plan do not result in net salary savings because the budget for each officer is not sufficient to meet the actual costs when an officer works full time. Specifically, we estimated that the department would experience a net deficit of about \$193 million related to its funding of correctional officers and overtime in fiscal year 2001–02.

To reduce its use of overtime, the department should fill vacant relief officer positions currently in its Institutional Vacancy Plan once it has filled its positions currently vacant because of insufficient staff.

***Department Action: Partial corrective action taken.***

The department states it is making every effort to fill vacant positions. The department reports that it has reduced its vacant permanent full-time positions to 429 as of June 30, 2003, compared to 1,040 at June 30, 2002. It also indicates that 160 additional cadets were scheduled to graduate in August 2003, and another 504 in October 2003. Finally, the department notes that it continues to work with the administration related to its long-term staffing needs, including developing a strategy related to the remaining vacant relief officer positions in its Institutional Vacancy Plan.

**Finding #3: A more strategic assignment of new cadets and better monitoring of overtime worked at each prison would be beneficial.**

The department does not consider the varying amounts of overtime that correctional officers work at its prisons when assigning cadets from its academy. In particular, based on our review of the November 2001 academy, we found that there was no strong correlation between the assignments of new cadets and the amount of overtime at each prison. In addition, we found that a total of 235 officers at 26 different prisons averaged more

than 80 hours of overtime each work period between July and December 2001. The department could also better protect the health and safety of everyone in the prison setting by more evenly distributing the total overtime among individual officers within each prison.

To reduce health and safety risks for its employees, the department should reassess the number of budgeted full-time positions at each prison and determine whether reallocations are warranted because of excessive overtime at specific prisons. Additionally, the department should pursue options to limit overtime that individuals work so that individuals do not exceed the 80-hour cap considered relevant for health and safety risks.

To better match the supply of correctional officers with the demand for correctional officers that use of overtime hours indicates, the department should consider assigning its academy graduates to those prisons that experience the highest levels of overtime. For example, if it has too many qualified candidates to fill a class, the department could give preference to candidates willing to go to the 10 prisons with the most overtime.

***Department Action: Partial corrective action taken.***

The department states that it is conducting a standardized staffing study that will assess staffing needs and establish standardized staffing patterns for each prison based on mission and location. In addition, the department reports that the number of correctional officers averaging more than 80 hours of overtime has decreased from the 235 we reported for July through December 2001, to 159 for January through June 2003. Further, the department states that until the pool of candidates on its correctional officer certification list increases significantly, competition is inadequate to make high vacancy institutions attractive to correctional officer candidates. Nevertheless, the department will continue efforts to increase the pool of candidates willing to work at high vacancy institutions.

**Finding #4: Certain provisions of the new labor agreement increase the department's fiscal burden and limit management's control.**

The new labor agreement between the State and the California Correctional Peace Officers Association includes many provisions that either increase personnel costs or create challenges for the department to effectively manage its staff. Ranging from salary

increases and enhanced retirement benefits to seniority-based overtime, some of these provisions were included in the prior labor agreement, but many are new to the labor agreement that was ratified in February 2002. The department estimates that the annual cost of new provisions in the agreement will be as high as \$300 million a year by fiscal year 2005–06, the latest year for which it has estimated costs. In developing these estimates, the department included classes of employees who are covered by the agreement, such as medical technical assistants and correctional counselors, as well as correctional officers. Focusing mainly on costs related to correctional officers and including the entire term of the labor agreement, we analyzed five new and three continuing provisions of the labor agreement and estimate that the department’s annual costs for these provisions will eventually amount to about \$518 million. Further, several changes in the provisions related to sick leave have likely resulted in additional overtime to cover for the increased use of sick leave. Finally, a continuing provision related to how post assignments are made limits the department’s ability to assign particular individuals to posts of its choosing.



# GOVERNOR'S OFFICE OF EMERGENCY SERVICES

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## ***Investigations of Improper Activities by State Employees, March 2002 Through July 2002***

**ALLEGATION I2000-607 (REPORT I2002-2),  
NOVEMBER 2002**

**Governor's Office of Emergency Services' response as of  
September 2002<sup>1</sup>**

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### ***Investigative Highlights . . .***

*The Governor's Office of  
Emergency Services engaged  
in the following improper  
governmental activities:*

- Allowed an employee  
(employee A) to continue  
to be paid for his  
commute time.*
  - Entered into an agreement  
with employee A's  
bargaining unit that  
the Department of  
Personnel Administration  
determined was invalid.*
  - Failed to follow its own  
administrative controls  
concerning overtime.*
- 

In April 2000 we reported, among other things, that poor supervision and inadequate administrative controls in the fire and rescue branch of the Governor's Office of Emergency Services (OES) had enabled employees to commit various improprieties, including claiming excessive overtime and travel costs.<sup>2</sup> Subsequently, we received information that one employee (employee A) continued to claim excessive amounts of overtime. We investigated and substantiated this and other improprieties.

### **Finding #1: Despite prior knowledge, OES continued to pay employee A for his commute.**

State policy prohibits state agencies from paying employees for time spent commuting from their home to the work site. Even though OES became aware that this was occurring as early as November 1998, it continued to allow employee A to claim his commute time, which contributed, in part, to the extraordinary amount of overtime he subsequently received. Specifically, during the fiscal year July 1, 1999, through June 30, 2000, employee A received approximately \$100,207 in wages, of which \$35,743, or 36 percent, was overtime pay. For the next fiscal year, July 1, 2000, through June 30, 2001, he was paid approximately \$107,137, of which \$40,523, or 38 percent, was overtime.

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<sup>1</sup> Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2004, this is the date of the auditee's latest response.

<sup>2</sup> When we notified the director of OES in 2000 that we would be investigating the allegations made at that time, he informed us the CHP had begun a similar investigation at OES's request. To avoid duplicating investigative efforts, we met and coordinated with the CHP. We reported these improprieties in investigative report I2000-1.

Although much of employee A's overtime related to emergency events, nearly half was associated with nonemergency activities such as meetings or training classes. For example, of 815 hours of overtime employee A claimed in fiscal year 1999–2000, 370 hours, or approximately 45 percent, was for nonemergency events. In fiscal year 2000–01, he claimed 862 hours of overtime, of which 390 hours, or about 45 percent, pertained to nonemergency activities.

**Finding #2: Employee A may not have been told to stop claiming his commute time.**

Employee A and his managers have provided conflicting information regarding whether he was told to stop claiming his commute time. In July 1999, as our prior investigation drew to a close, we spoke with the former manager of the fire and rescue branch about the matter.<sup>3</sup> He told us that it was his understanding that employee A had been told that he no longer could claim his commute time and that he had stopped doing so. During our current investigation, employee A told us that it had always been his understanding that his home was his designated headquarters and, as a result, he claimed the time it took him to drive from his home to locations within his assigned work area. He added that to compensate for this, he sometimes did not claim all the time he spent conducting state business, such as when he worked late or responded to e-mail messages or pages on his days off. It is unclear to us why, if employee A believed this arrangement was appropriate, he felt he needed to compensate in some way for charging commute time as work hours. Regardless, we found no written evidence that OES instructed the employee that he no longer could claim his commute.

Employee A not only continued to claim his commute time, but it appears that OES never intended to prevent him from claiming this time unless it could reassign him to a work area closer to his home. In a letter dated April 7, 1999, the former manager thanked the chief of a fire district located within employee A's work area for offering OES the ability to locate one of its employees, employee A, at the fire district's headquarters. However, the former manager added, "We have reevaluated our situation and do not currently plan to relocate [employee A's] office from his current home office at this time." OES allowed the abuse to continue by declining the offer to move the employee's office from his home to a more central location within his assigned work area.

<sup>3</sup> This manager retired from OES effective March 30, 2001.

**Finding #3: OES entered into a questionable agreement with employee A's bargaining unit.**

On April 7, 1999, the same day OES formally rejected the chance to relocate employee A's office to a location within his assigned work area, OES entered into a questionable agreement with employee A's bargaining unit. Further, not only did OES enter into this questionable agreement with employee A's bargaining unit—an agreement that the current manager of the fire and rescue branch believes permitted the employee to continue to claim his commute—but it also did not provide the Department of Personnel Administration (DPA) an opportunity to review and approve the agreement as required. When we asked the appropriate DPA official to review the agreement, he questioned its appropriateness and said he considered it invalid.

**Finding #4: The Fire and Rescue Branch still does not adhere to administrative controls concerning overtime.**

Because the Fire and Rescue Branch (branch) failed to follow its own administrative controls concerning overtime, employees have continued to incur nonemergency overtime that lacked advance authorization. In an attempt to address the past failure of the branch to control excessive nonemergency overtime and related expenses, OES reported to us on February 10, 1999, that it had implemented an administrative system that required employees in the branch to submit in a timely manner various documents that included but were not limited to a monthly calendar of planned activities, overtime authorization and claim forms, authorization for on-call hours, and absence and time reports. OES reported that supervisors would compare each document with previously approved authorizations and individual planning documents to ensure agreement and to continuously monitor overtime use and travel expenses. However, one supervisor responsible for performing these control functions admitted that some employees under his supervision had not submitted the appropriate documents by the third working day of each month, as required. As a result, the supervisor said that there might have been instances when he was not able to review and approve planned overtime and travel incurred by employees under his supervision.

Although we did not perform an extensive review of the records of each employee in the branch, we did note several instances in which employees did not receive advance approval of nonemergency overtime. For instance, during July 1999, employee A claimed 84.5 hours of overtime, 73 of which related

to nonemergency events. However, none of the documents we obtained from the branch show that employee A received prior approval for the nonemergency overtime he claimed. In June 2000, of 99.5 hours of overtime claimed by employee A, 60.5 hours were nonemergency overtime. Again, the documents we obtained did not show that employee A obtained prior authorization to work the overtime. In June 2001, another employee, employee B, claimed 43.75 hours of overtime, all for nonemergency events. Yet none of the documents we reviewed indicated that he had received prior approval for the overtime. Given that employee A and the rest of the branch historically have incurred significant amounts of nonemergency overtime, we believe it would be prudent for OES to follow its own administrative procedures designed to monitor and control overtime and travel costs.<sup>4</sup>

***OES Action: Corrective action taken.***

OES reported that the unresolved supervisory and administrative issues associated with the branch were a result of miscommunications during changes to branch management or inadequate training, but that these issues have now been addressed. Employee A has been reassigned to a work area where he lives. OES also reported that it has established administrative controls concerning overtime authorization and that it has counseled all branch employees that nonemergency overtime will not be incurred without prior authorization.

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<sup>4</sup> We previously reported that only 41 percent of overtime claimed by employees at the branch from November 1996 through June 1997 related directly to emergency conditions.

# DEPARTMENT OF INDUSTRIAL RELATIONS

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## ***Investigations of Improper Activities by State Employees, August 2002 Through January 2003***

ALLEGATION I2002-605 (REPORT I2003-1), APRIL 2003

Department of Industrial Relations response as of April 2003

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### ***Investigative Highlight . . .***

***A Department of Industrial Relations official claimed reimbursement for more than \$17,000 in travel expenses to which he was not entitled.***

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**W**e investigated and substantiated allegations that an official with the Department of Industrial Relations (department) improperly claimed reimbursements for relocation and commute expenses for travel between his residence near San Diego and his headquarters in San Francisco. We also found that the official improperly claimed payment for lodging and meals incurred within a close proximity of his headquarters. At the time we received the allegation, the department was already investigating these issues, and we asked that it report its findings to our office. The department concluded that the official improperly claimed \$5,726 in travel costs related to relocation and lodging expenses. After receiving the department's report, we performed some additional analysis and follow-up work and determined that the official had claimed an additional \$11,803 in improper travel expenses.

### **Finding #1: The official claimed relocation expenses but did not relocate.**

The State reimbursed the official for relocation expenses when he neither relocated nor obtained the necessary approval for the reimbursement. The department found that \$4,939 of the official's \$4,982 claim for relocation expenses was improper, and it recommended disallowing these costs. However, the department allowed the remaining \$43, which represents a 9-cent-per-mile reimbursement for relocation travel between the official's home near San Diego and his headquarters in San Francisco. However, we determined that the State should not have paid the \$43 because the official did not relocate.

***Department Action: Corrective action taken.***

The department agrees with our finding and required the official to reimburse the State for improper relocation expenses totaling \$4,982.

**Finding #2: The official submitted improper claims for lodging and meal expenses.**

The official made improper claims for lodging and meals. The department reported that the official improperly received \$787 in reimbursement for unallowable lodging expenses that he incurred within 50 miles of his headquarters location. Our analysis determined that the official also improperly received \$1,082 in meal and incidental expenses incurred within 50 miles of his San Francisco headquarters.

***Department Action: Corrective action taken.***

The department agrees with our finding and required the official to reimburse the State a total of \$1,869 for lodging, meal, and incidental expenses incurred within 50 miles of his headquarters.

**Finding #3: The official claimed and the department approved other unallowable and unnecessary expenses.**

Of the \$47,790 in travel costs the official incurred between April 2000 and November 2001, the State paid \$2,334 for 24 days of lodging in San Diego, which is within 35 miles of the official's home, \$3,941 for flights between San Diego and his San Francisco headquarters, and \$3,768 more than he was entitled to receive for costs associated with flights between San Diego and Sacramento.<sup>1</sup>

We also found that the official claimed unnecessary rental car expenses. A portion of the rental car expenses the official claimed was for weekend rentals for which he stated no business purpose. Although the department did not address the issue, we found that of the \$3,417 in rental car expenses the official incurred during the 20-month period we reviewed, \$635 related to vehicles he rented in San Diego on weekends.

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<sup>1</sup> The \$47,790 includes \$31,831 in travel claims that the official submitted for reimbursement and \$15,929 in travel expenses not included on a travel claim, but that the State paid directly to a vendor. This figure does not include any relocation expenses.

Finally, we found that even though a majority of the \$31,831 in travel claims that the official submitted lacked sufficient explanations for his trips, as state regulations require, the department approved his claims. We spoke with two executives about the department's process for reviewing and approving travel claims, because they had approved a number of the official's claims. Both executives told us they do not or usually do not attempt to verify the purpose of each trip listed on the claims.

***Department Action: Partial corrective action taken.***

➡ The department reported that it will require an executive-level civil service officer familiar with state reimbursement rules to authorize all exempt employee travel claims before submitting them to the accounting department for processing. The department also reported that it will require a senior level (or higher) accounting officer to audit all exempt employees' travel claims before making payment. After the department began its investigation of the official's travel expenses, and well after the official had incurred the expenses and received reimbursement, the department decided that, for the purpose of determining which costs were valid and in compliance with state requirements, it would consider the official's San Francisco headquarters to be his "primary residence." This determination was based on the California Code of Regulations, Title 2, Section 599.616.1(b), which states that a place of primary dwelling shall be designated for each state officer and employee and that the primary dwelling shall be defined as the actual dwelling place that bears the most logical relationship to the employee's headquarters and shall be determined without regard to any other legal or mailing address.

➡ The department's determination that the official's primary dwelling was one and the same as the San Francisco headquarters allowed the official to travel between San Francisco and San Diego at state expense, based on the assumption that all such travel is for a business purpose. Consequently, the department did not recommend that the official repay the State for \$2,334 in lodging expenses and \$635 in rental car expenses he incurred in San Diego, the \$3,768 overpayment for trips the official took between San Diego and Sacramento, or the \$3,941 in airfare for flights between San Diego and San Francisco. Since the department determined that for the purpose of calculating travel expenses, the official's residence is his headquarters in San Francisco and not where he resides (near San Diego),

these expenses became allowable; however, we question this determination and find no indication that the official's headquarters is an "actual dwelling place." Moreover, the department does not appear to have used the best interests of the State as its guiding principle when making this after-the-fact determination that contradicted statements on the travel claims.

# DEPARTMENT OF DEVELOPMENTAL SERVICES, PORTERVILLE DEVELOPMENTAL CENTER

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## ***Investigations of Improper Activities by State Employees, August 2002 Through January 2003***

ALLEGATION I2002-952 (REPORT I2003-1), APRIL 2003

Department of Developmental Services response as of October 2002<sup>1</sup>

The Department of Developmental Services (department) investigated and substantiated an allegation that the Porterville Developmental Center (center) illegally appointed two individuals to psychologist positions.

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### ***Investigative Highlights . . .***

*Porterville Developmental Center:*

- Failed to verify whether two employees had completed the education requirements for the positions to which they were appointed.*
  
  - Accepted two additional applications after the final filing date had already passed.*
- 

### **Finding #1: The center illegally appointed two individuals to psychologist positions.**

In violation of state law, the center appointed two individuals, employee A and employee B, to psychologist positions, even though neither of the individuals met the educational requirements for the position.

Specifically, employee A began working for the center as a psychology intern in October 1999. That position required enrollment in and completion of at least one year of a postgraduate program leading to a doctoral degree in psychology. When employee A applied for the intern position, she projected a completion date of May 2000 for her doctorate. In August 2000, employee A applied for the psychologist position and revised her projected completion date for her degree to September 2000. Although the center appointed employee A to a psychologist position in October 2000, no one verified that she had completed her doctoral degree, even though completion of the degree is required prior to

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<sup>1</sup> Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2004, this is the date of the auditee's latest response.

such an appointment. As of July 31, 2002, employee A still had not met the educational requirements for the position she had been working in for nearly two years.

Similar to the situation with employee A, no one at the center verified whether employee B had completed his doctoral degree prior to his appointment as a psychologist.

**Finding #2: Employee A and center employees failed to follow other center hiring procedures.**

On July 28, 2000, a program within the center advertised a vacancy for a psychologist position. As of the August 4, 2000, final filing date, the exams unit had received two applications, one from employee C and one from employee D, which it forwarded to the appropriate program to schedule interviews. Subsequently, a nursing coordinator for the program directly accepted applications from employee A and another employee, employee E. The exam analyst later wrote a note on employee E's application form acknowledging that the employee had changed his mind and decided to apply for the position. Center procedures state that an applicant submitting an application after the final filing date must obtain approval from the center's personnel officer for admission to the interview process.

However, no record indicates that the exams unit was aware that the nursing coordinator also directly accepted an application from employee A. Neither employee A nor the nursing coordinator notified the exams unit of employee A's application; as a result, the exams unit did not find out about the application until after it had interviewed employee A and approved her appointment to the position.

***Center and Department Action: Corrective action taken.***

The department conferred with the State Personnel Board and has taken corrective action by having employees A and B voluntarily transfer to psychology-associate positions. In addition, the center has implemented new procedures to prevent this type of illegal appointment from occurring in the future. The new procedures include a stringent process for review of applicants' credentials by at least three levels of personnel, including two levels at the center and one at the department.

# DEPARTMENT OF FISH AND GAME

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## ***Investigations of Improper Activities by State Employees, August 2002 Through January 2003***

ALLEGATIONS I2002-636, I2002-725, AND I2002-947 (I2003-1), APRIL 2003

Department of Fish and Game's response as of February 2003<sup>1</sup>

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### ***Investigative Highlights . . .***

*Employees of the Department of Fish and Game (department) engaged in the following improper governmental activities:*

- Improperly claimed 479 hours of leave balances, a benefit worth approximately \$20,322, to which he was not entitled.*
  - Circumvented competitive-bidding requirements.*
  - Violated conflict-of-interest prohibitions.*
  - Mistreated subordinates and breached other norms of good behavior in a way that brought discredit to the department.*
- 

We asked the Department of Fish and Game (department) to investigate on our behalf allegations that a regional manager claimed vacation and sick leave hours he was not entitled to receive, engaged in various contracting improprieties, and mistreated employees.

### **Finding #1: The department mismanaged its leave-accounting system.**

A manager of one of the department's regions failed to ensure his region made monthly updates to the State's leave-accounting system for more than two years, and even after the region took steps to bring the system up to date, the manager improperly claimed 479 hours of leave balances to which he was not entitled.

The State's leave-accounting system tracks vacation, sick leave, and annual leave as well as other employee leave balances, such as compensatory time off and personal holidays. The leave-accounting system automatically posts credits to the employees' monthly leave balances, but regional staff must account for any leave its employees have taken—which it had not done for more than two years. Thus, for the 180 regional employees the manager oversaw, the region reported leave balances that were greater than the employees' actual balances. In doing so, the region exposed the State to undue liability in that employees might have taken more leave than they were entitled to. Also, employees may have found planning vacations difficult, given

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<sup>1</sup> Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2004, this is the date of the auditee's latest response.

that they did not receive an accurate accounting of their leave balances. To correct this problem, regional staff, under the manager's direction, began reconciling each employee's leave balances. In most cases, staff assigned to perform the reconciliation easily resolved cases in which individuals identified discrepancies. In some instances regional staff were unable to locate employees' time sheets. In such cases, their only recourse was to grant those employees the automatic leave accrual, even though the employees might already have taken time off, because the region lacked supporting documentation by which to reduce the employee's leave balances. However, some controversy remained involving the manager's leave balances. The manager disputed his staff's recalculation and rather than provide documentation to support his dispute, he supplied staff with amounts he believed were correct. When the department's investigators questioned him, the manager stated that he had support for these adjustments; however, after reviewing the information the manager provided, the department concluded that the support was inadequate. The department concluded that the manager received a combined 479 hours of sick leave and annual leave that he was not entitled to, a benefit worth approximately \$20,322.

**Finding #2: The manager and other employees violated contracting and conflict-of-interest laws.**

Contrary to state laws, regional staff split various transactions into smaller ones enabling them to circumvent competitive bidding requirements. These transactions related to the purchase of equipment or services provided by companies that a seasonal employee of the department owned or was affiliated with. For example, from February through June 2001, two companies—the employee owned one and founded the other—invoiced the department a total of \$62,000 for five underground storage tanks used to provide water for sheep and deer. Instead of treating this as one transaction, regional staff spread these costs among five purchase orders, thereby circumventing competitive-bidding requirements. In addition, supporting documents associated with the purchase of the five underground storage tanks lacked evidence that the department actually obtained competitive bids. The manager and regional staff also allowed one of the companies to begin work related to the underground storage tanks before the department had established contracts for the work, thereby exposing the State to additional liabilities. The department concluded that the seasonal employee violated

conflict-of-interest prohibitions because one of his companies submitted a \$10,667 invoice for one underground storage tank at the time he was a state employee.

**Finding #3: The manager mistreated subordinates.**

The department investigated several complaints concerning the manager's conduct and concluded that the manager made sexually suggestive comments or jokes in the presence of female staff members (who found his comments offensive), made inappropriate gestures to a staff member on several occasions, repeatedly cursed in staff members' presence, and intimidated staff by yelling at them to an extent that they perceived as unprofessional.

***Department Action: Corrective action taken.***

The department initiated an administrative action against the manager for violating provisions of the Government Code: inexcusably neglecting his duty; treating the public or other employees inappropriately; and breaching other norms of good behavior, either during or after duty hours, in a way that discredited the department. A subsequent May 2002 agreement between the department and the manager called for a reduction in the manager's pay by 5 percent for five months, a reduction in his leave balances by 479 hours; and required the manager to complete department-specified training, including topics on management techniques, equal employment opportunity, conflicts of interest, and contracting. However, the department did not reduce the manager's leave balances by the agreed-upon amounts until February 4, 2003, after we made further inquiries into the matter.



# CALIFORNIA UNEMPLOYMENT INSURANCE APPEALS BOARD

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## ***Investigations of Improper Activities by State Employees, February 2003 Through June 2003***

ALLEGATION I2002-661 (REPORT I2003-2),  
SEPTEMBER 2003

California Unemployment Insurance Appeals Board's response  
as of September 2003

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### ***Investigative Highlights . . .***

*The California Unemployment  
Insurance Appeals Board  
engaged in the following  
improper governmental  
activities:*

- Improperly granted leave  
valued at an estimated  
\$170,314 to 314 of its  
nonexempt employees who  
it already compensated for  
their overtime.*
  - Failed to maintain  
accurate time and  
attendance records for  
each employee.*
- 

**W**e investigated and substantiated an allegation involving the California Unemployment Insurance Appeals Board (Appeals Board) improperly granting unofficial time off to employees even though it had already compensated them for the overtime they worked.

### **Finding: The Appeals Board improperly granted leave that resulted in economic waste.**

The Appeals Board improperly granted four days of leave to most of its employees. The Appeals Board employs 517 employees, consisting of both exempt and nonexempt employees. Exempt employees who work time in excess of the minimum average workweek shall not be compensated in overtime or compensatory leave. In contrast, the Appeals Board can either pay or award leave to nonexempt employees for overtime worked. In October 2001, the Appeals Board and the bargaining unit representing the Appeals Board's administrative law judges (who are exempt employees) entered into an agreement to grant these employees one day off each quarter in 2002 in exchange for an increased workload.

The Appeals Board has some flexibility in granting informal leave to exempt employees who work substantial overtime, but the same flexibility may not extend to granting leave to nonexempt employees. Nevertheless, the Appeals Board decided to also grant four days of informal administrative leave to its 314 nonexempt employees, even though it had already compensated those employees for overtime worked, resulting in an economic loss to the State. We could not determine the exact loss to the State since

the Appeals Board does not use the State Controller's Office's leave accounting system nor does it have a formal method to track the leave it grants to its employees. However, the leave improperly granted to 314 nonexempt employees totaled an estimated \$170,314. The Appeals Board also violated state regulations when it failed to keep complete and accurate time and attendance for each employee.

***Agency Action: Partial corrective action taken.***



The California Labor and Workforce Development Agency (agency), to whom the Appeals Board reports, disagreed with our conclusion that the Appeals Board improperly granted leave. The agency argued that Government Code, Section 19991.10, provides departments broad discretion to grant administrative time off as part of the appointing power's basic authority to manage its departments and that the statute sets forth no standards or criteria and provides no limitations upon the granting of such leave, except that no paid leave shall exceed five working days without prior approval of the Department of Personnel Administration (Personnel Administration). The agency also pointed out that the State Personnel Board (SPB) defined administrative time off as paid time granted by an appointing power to employees for the good of the service, to promote morale, and for other good reasons. However, the agency failed to note that the SPB also provided examples of the specific types of situations where administrative time off has been granted, such as when the appointing power determines that the safety of the employees is better served by their remaining at home or when work facilities have been destroyed or rendered uninhabitable because of lack of heat or electricity. Current state regulations related to Government Code, Section 19991.10, support the SPB's interpretation in that the regulations allow appointing powers to grant such employees administrative time off in emergency situations, but do not provide additional guidance on how the discretion provided by Section 19991.10 of the Government Code may be exercised. Thus, the Appeals Board's use of administrative leave in this case does not appear to be consistent with the intent of state law and regulations. We also believe that the Appeals Board's decision to grant administrative leave to those employees who it already compensated for overtime is wasteful and duplicative.

Notwithstanding, the agency said that it has asked Personnel Administration to review and provide written clarification on the matter and that it would instruct the Appeals Board to abide by any instructions Personnel Administration provides. With regard to our conclusion that the Appeals Board failed to track its employees' use of the administrative leave, the agency reported that it believed there was an internal misunderstanding surrounding the recording of administrative leave granted because the Appeals Board did not provide its employees with clear directions on how to record such leave. As a result, the agency directed the Appeals Board to develop a formal policy for the reporting of such absences.



# DEPARTMENT OF TRANSPORTATION

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## ***Investigations of Improper Activities by State Employees, February 2003 Through June 2003***

**ALLEGATION I2002-700 (REPORT I2003-2),  
SEPTEMBER 2003**

**Department of Transportation's response as of September 2003**

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### ***Investigative Highlights . . .***

***A Caltrans' employee engaged in the following improper governmental activities:***

- Misappropriated \$622,776 by requesting purchases and confirming the receipt of products that Caltrans did not receive.***
  - Directed a company to hold state funds outside the State Treasury and act as a fiscal agent without approval.***
- 

**W**e investigated and substantiated an allegation that an employee for the Department of Transportation (Caltrans) misappropriated \$622,776 in state money. Our investigation showed that the employee submitted two purchase requests for products the department never received. The employee arranged for the company to hold these funds from these fictitious purchases and act as the State's fiscal agent.

### **Finding: An employee misappropriated state funds.**

The employee misappropriated \$622,776 by submitting two purchase requests. After submitting the purchase requests, the employee directed the company to cancel delivery of the items and hold the payments in a company maintained account. In addition to initiating the purchase, the employee also verified the receipt of the products even though the company never sent these items. According to the employee, she directed the company to hold these funds outside the State Treasury and act as a fiscal agent to correct clerical errors and purchase training and information technology (IT) products for her unit.

In addition, poor management contributed to the misappropriation of funds. The employee's manager did not verify the receipt of the products on the fictitious purchases. The employee's unit gave the employee the responsibility and authority to request products, ensure their receipt, and monitor the funds used, which created the opportunity to misappropriate the funds.

Although Caltrans cannot completely account for the misappropriated funds, it paid unauthorized taxes and fees to the company. The balances that the employee and the company

maintained did not reconcile partly because the company commingled state funds with its own. However, the State did pay unauthorized taxes and fees. The company retained \$44,191, which represented sales taxes associated with the false purchase requests, and charged the State \$68,505 to maintain the account. Although the company likely earned interest during the two-year period it retained these funds, it did not allocate this interest to the State. Nevertheless, the company remitted \$75,698 to Caltrans, an amount it considered to be the balance the State paid for undelivered products.

***Caltrans' Action: Partial corrective action taken.***

Caltrans reported that it reinstated its prior policy of having all IT purchases shipped to, received, accepted, inventoried, and tagged by its Shipping and Receiving and Property Control units. Further, Caltrans reported that it initiated a practice of utilizing the Department of General Services' Technology and Acquisitions Support Branch for all IT procurements over \$500,000. Caltrans transferred the employee to another branch where her duties do not include procurement-related duties and will take appropriate disciplinary action against the employee upon completion of its review of case documentation. Caltrans added that it has contacted the appropriate law enforcement agencies to investigate any criminal implications or activity relating to the misappropriation. Caltrans also reported that it will make appropriate changes to its procedures after completing a review of its internal controls related to approval authorizations and documentation.

# PUBLIC UTILITIES COMMISSION

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## ***Investigations of Improper Activities by State Employees, February 2003 Through June 2003***

**ALLEGATION I2002-753 (REPORT NUMBER I2003-2),  
SEPTEMBER 2003**

**Public Utilities Commission response as of September 2003**

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### ***Investigative Highlights . . .***

***A supervisor with the Public Utilities Commission (PUC):***

- Improperly deposited into his personal bank account \$80,759 he received from PUC-sponsored conferences he oversaw during 1999, 2000, and 2001.***
  - Achieved a profit of \$37,542 after paying conference expenses.***
  - Used \$1,408 in funds he received during the 1999 conference to pay for alcohol.***
- 

**W**e investigated and substantiated that a supervisor with the Public Utilities Commission (PUC) improperly deposited into his personal bank account funds he received from the annual state railroad conference (conference) he oversaw.

### **Finding #1: The supervisor improperly deposited conference funds into his personal bank account.**

In violation of state law, the supervisor improperly deposited into his personal bank account at least \$80,759 he received as a result of his involvement with the conference. Specifically, between June and August 1999, he deposited \$30,056 in checks he received from various individuals or groups of individuals who attended that year's conference. Between May and August 2000, the supervisor deposited into his personal account \$8,835, representing a \$95 registration fee for as many as 93 individuals. The following year, between July and October 2001, the supervisor deposited \$41,868 in his personal account, most of which related to \$200 registration fees for more than 130 attendees.

The supervisor maintained that the conference was not a state-sponsored function but rather a joint effort involving various representatives from government, railroad companies, and consulting firms. He reasoned that the State paid only for registration and per diem costs for state-employed attendees and that no one, including his supervisors, indicated that he was handling conference funds inappropriately. Nonetheless, the decision to manage these funds outside the State Treasury is not consistent with state law. The law characterizes funds as public

funds when employees receive them in their official capacity. Documentation such as conference announcements, registration forms, hotel contracts, and check copies clearly demonstrate that these events were advertised as a state conference that the PUC endorsed and that the supervisor acted in his official capacity with the State when he accepted payments related to the conference.

**Finding #2: The supervisor profited from his involvement with the state conference.**

Because the PUC allowed the supervisor to control conference funds outside of approved state accounts, he was able to retain as much as \$37,542 in profits. State law prohibits state employees from engaging in any employment, activity, or enterprise that is clearly inconsistent, incompatible, in conflict with, or inimical to their duties as state officers or employees. Incompatible activities include using state time, facilities, equipment, supplies, and the prestige or influence of the State for one's own private gain or advantage. Our analysis indicates that the supervisor profited by at least \$3,725 from the 1999 conference; \$3,386 from the 2000 conference; and \$30,431 from the 2001 conference.

We asked the supervisor to review our calculations and provide any additional evidence, particularly concerning any conference-related costs that might demonstrate he had not profited from these events. The supervisor insisted that he had lost money each year on the conference and that he had maintained detailed accounting records that proved this until one of his superiors told him that he no longer needed to keep them. After reviewing the accounting records and invoices we obtained from each of the facilities that hosted the conferences, the supervisor stated that he had paid other costs, such as off-site dinners and mailing expenses, that these bills did not reflect. However, he was unable to provide documentation to support any of these additional costs.

**Finding #3: The supervisor used funds to pay for alcohol-related expenses.**

Of the money the supervisor received and paid for costs associated with the 1999 conference, we identified \$1,408 that pertained to alcohol-related expenses. State law prohibits state officers and employees from using state resources for personal enjoyment, private gain, or personal advantage or for an

outside endeavor not related to state business. As we mentioned previously, because state law characterizes the conference funds the supervisor received and deposited as public money, its use to purchase alcohol constitutes a misuse of public funds.

***PUC Action: Partial corrective action taken.***

The PUC discontinued the conference and plans to train all staff who may accept money from outside parties on proper record-keeping procedures and fiscal accountability. In addition, the PUC states it does not plan to initiate personnel action against the supervisor until it receives and completes its review of critical documentation.



# CALIFORNIA DEPARTMENT OF TRANSPORTATION

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## **Low Cash Balances Threaten the Department's Ability to Promptly Deliver Planned Transportation Projects**

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### **Audit Highlights . . .**

*Our review of the Department of Transportation's (department) delivery of projects in the State Transportation Improvement Program (STIP) and Traffic Congestion Relief Program (TCRP) revealed that:*

- A lack of cash in the State Highway Account will result in the California Transportation Commission (commission) allocating almost \$3 billion less than it had originally planned for STIP projects scheduled in fiscal years 2002-03 and 2003-04.*
- Funding uncertainties associated with the Traffic Congestion Relief Fund (TCRF) have resulted in the commission halting all TCRP allocations, including those to 15 projects that currently need \$147 million in order to continue work.*
- Delayed or cancelled transportation projects will affect the State's aging transportation infrastructure, resulting in deteriorated highways, more traffic congestion, and reduced air quality, as well as higher costs for California residents, in terms of wasted fuel and lost productivity.*

*continued on next page*

**REPORT NUMBER 2002-126, JULY 2003**

**California Department of Transportation's and the California Transportation Commission's responses as of January 2004**

The Joint Legislative Audit Committee asked us to examine the Department of Transportation's (department) delivery of projects in the State Transportation Improvement Program (STIP) and Traffic Congestion Relief Program (TCRP). We found that the department's ability to promptly deliver transportation projects is affected by low cash balances in the State Highway Account (highway account) and Traffic Congestion Relief Fund (TCRF), and consequently, delayed and cancelled transportation projects will negatively affect the State's aging transportation system. The low cash balances in the highway account and TCRF were caused by several factors.

Loans from the highway account and TCRF to the State's General Fund drained cash reserves from these accounts at the same time that the department saw highway account revenues decrease from weight fees. Further, uncertainties related to the former governor's mid-year spending proposal have caused the California Transportation Commission (commission) to halt all allocations to TCRP projects until the budget uncertainties are resolved. Moreover, the department's cash forecast updates continue to be optimistic, and consequently the department could end fiscal year 2003-04 with a negative account balance in the highway account. The department and the commission have alternatives to fund projects in the short-term. However, most of these alternatives also have the potential to decrease the future flexibility of scheduling projects for the STIP and one could be perceived as unfair, so the commission needs to carefully consider and set guidelines for their use.

☑ *Many of the commission's and the department's alternatives to provide needed funding for projects on a short-term basis have the drawback of reducing the department's flexibility to fund future projects, and one potential option available to the commission may be perceived as unfair.*

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**Finding: The department has insufficient cash to allow it and regional agencies to deliver planned transportation projects in the STIP and TCRP at the levels originally planned.**

Lacking sufficient cash in its major transportation funds and accounts, the department and regional transportation planning agencies are unable to deliver many of their planned transportation projects scheduled in the STIP and TCRP. Specific areas our audit identified include:

- Projected cash shortages identified by the department in its December 2002 cash forecast caused the department to temporarily halt allocations to STIP and TCRP projects. While the department's revised March 2003 cash forecast update prompted the commission to resume allocations to STIP (but not TCRP) projects, the department's estimates may be overly optimistic, and could result in the commission making allocations for which the department will lack available funds when later presented with reimbursement requests from implementing agencies.
- Although the commission resumed allocations to STIP projects in April 2003, the allocations are at dramatically lower levels than originally planned. Specifically, 194 projects needing \$103 million in order to move forward with the next phase of project delivery will not receive allocations in fiscal year 2002–03. Moreover, the commission's actual and planned allocations for fiscal years 2002–03 and 2003–04 is almost \$3 billion lower than the amounts originally planned.
- Minimal cash reserves in the TCRF will affect the department's ability to deliver at least 106 projects that require a minimum of \$3.4 billion more in allocations to continue work. Since December 2002, 15 TCRP projects have submitted requests for allocations totaling \$147 million, and work has ceased on 12 of these projects due to lack of spending authority.
- The former governor's May 2003 revision to the governor's budget threatens TCRF funds, calling for the Legislature to delay \$938 million of the transfer of state gasoline sales tax revenues from the General Fund to the Transportation Investment Fund (TIF). Because state law provides for only a set number of annual transfers of specified amounts from the TIF to the TCRF, delays or reductions in amounts transferred to the TIF could result in a permanent annual loss of revenues to the TCRF of up to \$678 million, unless the Legislature acts to obligate the General Fund to repay the TCRF in the future.

- Delayed or cancelled projects will affect the State's aging transportation system, resulting in deteriorated highways, increased traffic congestion, and reduced air quality. Additionally, delays in making improvements means that California residents will pay higher direct costs for wasted fuel and lost productivity. Also, consumers will pay increased indirect costs of the delays in the form of higher prices for goods and services, as well as compounding repair costs for fixing later what the department should fix now.
- The department and commission have alternatives that they could use to fund projects over the short term. However, many of these alternatives have the potential to make future project scheduling inflexible, and one option—pursuing the ability for the commission to rescind TCRP allocations—could be perceived as unfair.

We recommended that, considering the State's fiscal crisis, the Legislature may wish to allow the TIF to transfer the entire \$678 million to the TCRF, and then authorize a loan of the money from the TCRF to the General Fund so that those funds would be repaid to the TCRF and therefore still be available in future years.

Further, we recommended that the department do the following to ensure that it can meet its short-term cash needs:

- Continue its efforts to become more precise in revising its revenue and expenditure estimates and ensure that these revisions are properly supported and presented in cash forecast updates to the commission.
- Continue to cautiously pursue other funding alternatives (GARVEE bonds, SIB loans, direct-cash reimbursement, and replacement projects) to meet short-term project funding needs, and continue to set limits on these alternatives to avoid making future project scheduling inflexible.

Finally, we recommended that should the commission be granted the authority to rescind unspent allocations, it should carefully consider statewide priorities and ensure that all counties are treated fairly before taking such actions.

***Department and Commission Action: Partial corrective action taken.***

The department states that its cash management team has expanded its cash forecasting activities to include a monthly analysis and projection of construction payments to contractors, which compose a large portion of the department's monthly cash disbursements. The department reports that its cash management team is also in the process of refining monthly projections of expenditures in the toll bridge seismic retrofit account, the TCRF, and the public transportation account to improve its projection of cash in the transportation revolving account. The department further reports that its cash management team has adopted a conservative approach to projecting anticipated federal collections due to uncertainty over passage of the new federal transportation act. Finally, the department reports that aside from monitoring and forecasting cash balances on a daily basis, its cash management team continues to update its internal project tracking database to monitor allocations and expenditures on capital outlay and local assistance projects. The department reports that it presented a quarterly cash update to the commission in September 2003 with recommendations on the amount of cash available for project allocations.

The department agrees with our recommendation that it should continue to cautiously pursue other funding alternatives. The department has implemented the Transportation Finance Bank Revolving Program (SIB loans) and is still developing GARVEE financing.

The commission stated that it has not been granted the authority to rescind unspent allocations, so no action has taken place.

***Legislative Action: Unknown.***

We are not aware of any action taken by the Legislature to allow the TIF to transfer \$678 million to the TCRF and to authorize the loan of these funds to the General Fund.

# CALIFORNIA DEPARTMENT OF TRANSPORTATION

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## ***It Manages the State Highway Operation and Protection Program Adequately, but It Can Make Improvements***

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### **Audit Highlights . . .**

*Our review of the California Department of Transportation's (Caltrans) management of its State Highway Operation and Protection Program (SHOPP) found that:*

- Most SHOPP projects do not exceed their original funding allocation. Also, although most of the 20 projects we reviewed experienced time delays, the causes for the delays appear reasonable.*
  - Resident engineers did not always maintain complete records of project events. Without these records, Caltrans is vulnerable to contractor claims for more money and cannot accurately assess contractors for liquidated damages.*
  - Caltrans does not evaluate the financial stability of the surety insurers that issue performance and payment bonds to its contractors.*
  - Caltrans lacks comprehensive policies and procedures instructing district staff on how to document and address complaints from the public regarding projects.*
- 

**REPORT NUMBER 2002-103, AUGUST 2002**

**California Department of Transportation's response as of August 2003**

**T**he Bureau of State Audits examined the California Department of Transportation's (Caltrans) process for managing State Highway Operation and Protection Program projects. Specifically, we were asked to determine whether Caltrans is managing projects to ensure minimal or no cost overruns and time delays, contractors have valid performance bonds from solvent companies, and staff follow Caltrans' public relations policies and procedures.

### **Finding #1: Some construction engineers do not adhere to Caltrans' policies for managing projects.**

Some resident engineers, who manage the project construction costs and administer the contracts, are failing to keep adequate records of days with adverse weather conditions and days that contractors choose not to work on scheduled tasks. Thus, the State lacks necessary records of the causes for project delays and may not be able to assess and collect damages in disputes with contractors about days when they did not work. Also, some resident engineers do not get the required prior approval from the Division of Construction or the district director for construction change orders, which can lead to delays in processing the change orders and to interest charges for late payments to the contractors.

To ensure an adequate defense against contract disputes and to properly assess liquidated damages, Caltrans should ensure that resident engineers and assistant resident engineers maintain complete and accurate daily records of all relevant events occurring on working and nonworking days and that resident engineers complete the weekly statements accurately and in a timely manner. Further, Caltrans should ensure that

its staff obtain prior approval for construction change orders in a timely manner to avoid incurring any unnecessary costs, such as interest for late payments to the contractor, and to ensure that managers agree that proposed changes are necessary. Finally, to aid staff in properly managing construction projects, Caltrans should continue implementing its capital project skill development plan and ensure that staff continue to receive training after the plan expires.

***Caltrans' Action: Corrective action taken.***

Caltrans is developing an automated construction change order approval tracking system. According to Caltrans staff, this new system will improve the change order and approval process by documenting the required concurrence and prior approval for each construction change order. However, because of limited funding, this new system will not include the tracking of reported working days. Nevertheless, Caltrans has revised certain sections of its construction procedures and specifications manuals. Additionally, it has developed classes on contract administration, including a class specific to the tracking and reporting of working days.

**Finding #2: Although somewhat limited by state law, Caltrans can reduce the risk of loss to the state from poor contractor performance.**

Caltrans relies on state-required performance and payment bonds issued by a surety insurer (insurer) for loss protection when contractors fail to do the work as specified in the contract. However, although state law permits Caltrans to obtain financial statements from insurers, Caltrans believes it lacks authority to use those statements. Thus, it does not examine the insurer's financial statements, either at the beginning of or during a project, to evaluate its ability to cover possible project losses. However, because state law prevents Caltrans from knowing that the state's Department of Insurance is investigating an insurer that is on its list of approved insurers, it is important that Caltrans does its own checking of insurer's financial statements to reduce its risk of loss.

To ensure that Caltrans can collect on a performance bond if a contractor does not perform, we recommended that the Legislature consider expanding Caltrans' ability to use other financial indicators included within the financial statements and information available from rating companies such as A.M. Best Company and S&P as a basis for determining the

sufficiency of an insurer, before accepting performance bonds. Further, the Legislature should clarify Caltrans' authority to use the information it obtains from financial statements and other financial indicators to object to the sufficiency of an insurer throughout the bond term.

***Legislative Action: Unknown.***

We are not aware of any legislation that has passed to address this issue.

**Finding #3: Caltrans can improve its public relations process to avert negative publicity.**

Caltrans can better meet its goal of communicating effectively with the public about construction projects that inconvenience drivers. Caltrans provides guidance to the district offices, but it relies primarily on them to determine when and how to communicate with the public. Unfortunately, most district public information officers do not track the nature and resolution of the complaints they receive, so public dissatisfaction can grow unbeknown to either the public information officers or Caltrans' headquarters.

To ensure that districts handle complaints and inquiries consistently, Caltrans should develop comprehensive public relations policies and procedures that specify the process to use when responding to complaints, the documents that should be maintained, and the method that district offices should use to assess their public relations efforts. Further, Caltrans should monitor the district offices' public relations efforts periodically.

***Caltrans' Action: Corrective action taken.***

Caltrans has developed and fully implemented a new comprehensive process for addressing project complaints and requests for information, which includes ongoing monitoring of the districts' public affairs function by Caltrans' headquarters.



# DISABLED VETERAN BUSINESS ENTERPRISE PROGRAM

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## ***Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success***

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### *Audit Highlights . . .*

*Our review of the Disabled Veteran Business Enterprise (DVBE) program found that:*

- Many awarding departments do not report their DVBE participation levels; of those that do report, most do not meet the 3 percent participation goal.*
- The reasonableness of the 3 percent goal itself is not clear.*
- Outreach to potential DVBEs should be more aggressive.*

*Other factors that contribute to the State's failure to meet the DVBE goal are:*

- The program's overly flexible legal structure and limited clarifying regulations.*
  - The frequency with which certain departments exercise their discretion to exempt contracts from DVBE participation.*
  - Lack of effective evaluation of bidders' good-faith efforts and monitoring of contractors' compliance with contract DVBE requirements.*
- 

REPORT NUMBER 2001-127, JULY 2002

Audit responses as of July 2003 and October 2003<sup>1</sup>

The Joint Legislative Audit Committee requested that we determine the extent to which departments that award contracts (awarding departments) are meeting the 3 percent Disabled Veteran Business Enterprise Program (DVBE) participation goal and to identify statutory and procedural mechanisms that could assist in overcoming any barriers to fulfilling this goal. We found that many awarding departments do not report DVBE participation as required under law, and even fewer departments actually meet the goal. Specifically, we found:

### **Finding #1: Awarding departments' DVBE participation statistics are not always accurate, and the methodologies they employ are at times flawed.**

State law requires each awarding department to report to the governor, Legislature, the Department of General Services (General Services), and the Department of Veterans Affairs (Veterans Affairs) by January 1 each year on the level of participation by DVBEs in state contracting. General Services then issues a summary report.

Our own review showed that some awarding departments did not report DVBE statistics and others could not always provide supporting documentation for the DVBE statistics they reported. For example, for fiscal year 2000–01, the Department

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<sup>1</sup> Business, Transportation and Housing; State and Consumer Services; and Youth and Adult Correctional agencies and Departments of General Services, Transportation, and Veterans Affairs responses as of July 2003. Departments of Fish and Game and Health Services and Health and Human Services Agency responses as of October 2003.

of Fish and Game (Fish and Game) reported \$12.1 million in DVBE participation but could identify only \$431,000 in specific contracts, or less than 3.6 percent of the total. In addition, the Department of Health Services (Health Services) could not provide any summarized documentation for the numbers it reported. Health Services asserted that it had documentation in individual contract files to support its figures, but indicated it would be too time intensive to tally the information for our review.

Additional problems with the accuracy of DVBE participation information exist. The reporting methodology General Services established is contrary to statutory requirements. According to statute, the 3 percent DVBE participation goal applies to the overall dollar amount expended each year by the awarding department. However, under current reporting regulations issued by General Services, awarding departments must report the amount winning bidders “claim” they will pay to DVBEs under the contract. In its clarifying instructions, General Services has asked awarding departments to report the amounts “awarded” in contracts, rather than amounts actually paid to DVBEs.

To ensure DVBE statistics are accurate and meaningful, we recommended General Services require awarding departments to report actual participation and maintain appropriate documentation of statistics, continue its periodic audits of these figures for accuracy, and, if the audits reveal a pattern of inconsistencies or inaccuracies, address the causes in its reporting instructions.

***General Services’ Action: Partial corrective action taken.***

General Services has interpreted the statutes governing DVBE reporting to provide participation statistics to be reported based on the value of contracts awarded instead of dollars actually expended. According to General Services, this is the same methodology used in the small business participation report (California Government Code, Section 14840). General Services believes it is important to use consistent reporting standards to allow for program comparisons. Since its six-month response, based on the concerns raised by our office, General Services has revisited the issue and concluded that its own interpretation of the DVBE reporting requirements is reasonable and appropriate. We disagree with General Services’ interpretation of the DVBE reporting requirements. As we state on page 18 of the audit report, departmental reporting of actual payments [to DVBEs] provides more useful information because it focuses on the realized benefit to DVBEs.



As to the issue of requiring departments to maintain documentation of participation statistics, to reemphasize this administrative control procedure, General Services indicates it has added an instruction to the new participation report form that addresses the necessity of maintaining supporting documentation. Departments used this new form in reporting fiscal year 2001–02 cumulative participation statistics. General Services is also continuing to include the audit of the DVBE reporting process within its comprehensive external compliance audit program performed of other state agencies. It indicates it uses the results of these audits to identify areas for possible improvement within the reporting process.

**Finding #2: Not all state agencies have finalized and implemented their plans to monitor their departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, require a DVBE improvement plan.**

In June 2001, the governor issued executive order D-43-01, which requires all state agency secretaries to review the DVBE participation levels achieved by the awarding departments within their agencies. Further, the executive order requires each secretary to require awarding departments to develop an improvement plan if the 3 percent goal is not achieved or the data is not reported. Three of five state agencies responding to our survey indicated that they were still developing procedures to monitor the DVBE participation levels of their subordinate awarding departments.

We recommended those state agencies that have not already done so should finalize and implement their plans to monitor awarding departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, monitor their efforts to improve DVBE participation.

***Agency Action: Partial corrective action taken.***

On June 28, 2002, the governor directed that all state departments and agencies submit monthly reports to the State and Consumer Services Agency regarding DVBE participation. Based on the reporting forms developed by the State and Consumer Services Agency, state departments and agencies are required to report total contracting dollars,

dollars paid to DVBEs, and DVBE participation percentages. In addition, departments that have not met the 3 percent DVBE participation goal are required to explain why.

Each of the following state agencies indicates the development of plans to monitor awarding departments' reporting of DVBE statistics: State and Consumer Services Agency; Business, Transportation and Housing Agency; Health and Human Services Agency; and the Youth and Adult Correctional Agency. The Resources Agency did not provide a one-year update on its efforts to implement this recommendation. Some agencies reported increases in DVBE participation during the fiscal year 2001–02. In particular, the State and Consumer Services Agency reported a DVBE participation rate of 3.3 percent in 2002, which is an increase from 1.5 percent in the prior year. Further, the Business, Transportation and Housing Agency similarly reported an increase in DVBE participation, indicating 3.7 percent participation during the fiscal year 2001–02.

**Finding #3: The State does not know how many DVBEs can be certified and the extent to which they can provide needed goods and services to the State. As a result, the reasonableness of the 3 percent goal is uncertain.**

Even though the law establishes a 3 percent participation goal for every awarding department, our review did not find sufficient evidence to support the assumption that this is an equitable share of contracts for DVBEs. When the DVBE legislation was being drafted in 1989, several awarding departments opposed the bill on the grounds that the 3 percent goal was unrealistic.

The awarding departments' concern about enough DVBEs to justify the 3 percent goal seems to have been valid. As of May 2002, General Services had only 797 DVBEs certified and available for contracting. The services these DVBEs offered and their geographical distribution did not always match the State's needs. All five agencies responding to our survey and many awarding departments' improvement plans identified a limited pool of DVBEs as one of the impediments to meeting the 3 percent DVBE participation goal.

To determine if the 3 percent DVBE goal is reasonable, the Legislature may wish to consider requiring either General Services or Veterans Affairs to commission a study on the

potential number of DVBE-eligible firms in the State, the services they provide, and their geographic distribution, and compare this information to the State's contracting needs.

Based on the results of this study, the Legislature may wish to consider doing the following:

- Modify the current DVBE participation goal.
- Allow General Services to negotiate department-specific goals based on individual contracting needs and the ability of the current or potential DVBE pool to satisfy those needs.

***Legislative Action: None.***

We have found no indication that any study on DVBE-eligible firms has been commissioned. Further, the statutory requirement for the DVBE participation rate remains at 3 percent, while the reasonableness of this goal remains unclear.

***Veterans Affairs' Action: None.***

According to Veterans Affairs' September 2002 response to this recommendation, it appears that the department was intending to commission a study on the number of potentially DVBE-eligible firms in the State. However, the department's July 2003 update does not specifically address this recommendation.

**Finding #4: General Services is not sufficiently aggressive or focused in its outreach and promotional efforts for the DVBE program.**

As the administering agency for the DVBE program, General Services has been responsible for certifying eligible businesses as DVBEs and conducting promotional and outreach efforts to increase the number of certified DVBE firms.

It is unclear to what extent General Services' outreach activities target disabled veterans' groups. General Services was also unable to readily quantify its outreach activities. The information it ultimately provided was based on old personal calendars and planners. We also could not evaluate the effectiveness of these outreach activities since General Services only selectively monitors the results.

To ensure the DVBE program is promoted to the fullest extent possible, we recommended General Services aggressively explore outreach opportunities with the U.S. Department of Veterans Affairs and organizations such as the American Legion, Disabled American Veterans, and Veterans of Foreign Wars. In particular, General Services should cultivate a clear working relationship with county veteran service officers. It should also maintain complete records of its outreach and set up a system to track effectiveness. For example, General Services could consistently survey newly certified DVBEs to determine how they heard about the program and what convinced them to apply for certification. Finally, General Services and Veterans Affairs should continue to work to develop their joint plan for improving the DVBE program, finalizing and implementing it as soon as possible.

***General Services' and Veterans Affairs' Action: Partial corrective action taken.***

On June 28, 2002, the governor directed the implementation of a more intensive DVBE outreach effort, with the staff dedicated to that effort moved from General Services to Veterans Affairs. According to General Services, on August 1, 2002, the two DGS staff members performing the outreach function physically transferred to Veterans Affairs.

According to the July 2003 response from Veterans Affairs, it has completed the CDVA Disabled Veterans Business Enterprise Outreach Program Plan, which became effective April 1, 2003. The plan indicates that Veterans Affairs will introduce General Services "outreach team members" to veteran organizations' leadership and local county veteran services officers. However, Veterans Affairs also indicated that in May 2003, the two employees working on DVBE outreach, formerly from General Services, returned to that department. The plan also indicates that Veterans Affairs will establish working relationships with veteran service representatives and local county veteran service organizations.

**Finding #5: Some awarding departments exempt a significant number of contracts, potentially limiting their ability to maximize DVBE participation rates.**

Under statute, the DVBE participation goal applies to an awarding departments' overall expenditures in a given year. Therefore, awarding departments have the discretion to apply DVBE participation requirements on a contract-by-contract basis.

The frequency with which certain awarding departments exempt contracts from DVBE requirements is significant. Further, some of these awarding departments are not tracking the value of the contracts they exempt or the required compensating increase in participation goals for their remaining non-exempt contracts. For fiscal year 2000–01, two of the five awarding departments we reviewed, Health Services and Caltrans, did not compensate for these exemptions with increased participation on other contracts, and subsequently reported they did not meet the participation goal. According to our calculations, Health Services exempted 48 percent of DVBE-eligible contract dollars it reported in fiscal year 2000–01, which means it would have had to average almost 6 percent on all remaining eligible contracts to meet the goal. Similarly, General Services’ procurement division estimated that it exempted over 50 percent of its contracts during fiscal year 2000–01.

Awarding departments offer varying reasons for their exemption decisions. Some departments we reviewed exempt all contracts with certain characteristics, and the reasonableness of these blanket decisions may not be clear. For example, at least one unit within four of the five departments we reviewed has indicated it exempts all contracts it believes do not offer a subcontracting opportunity for DVBEs. However, this practice may significantly reduce a department’s chances for obtaining more DVBE participation.

To maximize DVBE participation, we recommended awarding departments attempt to use DVBEs as prime contractors instead of viewing them only as subcontractors. Further, the awarding departments should periodically examine the basis for their assumptions behind blanket exemptions for whole categories of contracts to ensure the exemptions are justified.

***General Services’, Caltrans’, Health Services’, and Fish and Game’s Action: Partial corrective action taken.***

General Services indicates it has policies and practices that actively encourage the use of DVBEs as prime contractors. Further, General Services has asserted that its chief deputy director stressed to General Services staff that all contracts include DVBE participation unless specifically exempted. Caltrans indicates that its DVBE exemption requests are researched to verify that no certified DVBEs are available in the particular geographic area specified to perform the work. Caltrans also indicates that it mails DVBE solicitation

materials to contractors who are on a special list of DVBEs and who provide services in the geographical area. Health Services similarly reported that it now reviews each DVBE exemption request by requiring its programs to explain why DVBE participation is not viable or possible. Health Services also requires that General Services' Web site be verified to ensure no DVBEs are available to perform likely subcontract services in the service location. Fish and Game asserts it does not have a blanket exemption by category type. However, it indicates that it does exempt contracts under \$10,000 from DVBE participation requirements. Fish and Game has determined that requiring bidders to undergo a good-faith effort to find and use a DVBE under these circumstances is not cost-effective. Fish and Game also indicates that if the lowest bidder on a contract is a DVBE, it awards the contract to the DVBE acting as a prime contractor.

**Finding #6: Awarding departments do not consistently scrutinize and evaluate good-faith effort documentation or ensure that DVBEs are actually being used as called for in contracts.**

The effectiveness of the implementation of the good-faith effort may be diminished by the lack of consistent or meaningful standards for awarding departments to follow when evaluating bidders' documentation of such efforts. Although statute requires General Services to adopt standards, it has not issued much direction to awarding departments on how to evaluate a bidder's good-faith effort. The State Contracting Manual offers appropriate suggestions for procedures in assessing good-faith effort, but the suggestions are not binding. There is also no clear requirement in statute requiring awarding departments to monitor actual DVBE participation to ensure the contractor is complying with the contract's DVBE requirements.

A common result of this lack of direction is the cursory evaluation of a bidder's good-faith effort documentation and inconsistent monitoring of actual DVBE usage. For example, Health Services does not instruct staff to independently verify bidders' statements that they solicited DVBEs to participate as subcontractors. Before February 2002, Health Services also lacked policy to monitor actual DVBE participation. Caltrans also does not follow up to ensure the DVBEs that the bidder claimed to have solicited were actually contacted. Although

Caltrans' procurement unit did have a policy to monitor actual DVBE participation to ensure contract compliance, we saw no monitoring consistent with this policy in a sample of their contract files.

To ensure that prime contractors make a genuine good-faith effort to find a DVBE, we recommended the Legislature consider requiring awarding departments to follow General Services' policies. General Services should issue regulations on what documentation the awarding departments should require and how they should evaluate that documentation. These standards should include steps that ensure the documentation submitted is accurate. Similarly, General Services should issue regulations on what steps departments should take to ensure contractors meet DVBE program requirements. These steps might include requiring awarding departments to monitor vendor invoices that detail DVBE participation or requiring the vendor and DVBE to submit a joint DVBE utilization report.

***Legislative Action: None.***

We found no indication that the Legislature has required awarding departments to follow General Services' policies regarding the evaluation of bidders' good-faith effort documentation.

***General Services' Action: Partial corrective action taken.***

Effective April 1, 2003, the procurement division of General Services revised its solicitation instructions and forms to require bidders to provide additional information and documentation on their compliance with DVBE program requirements. These new bidder instructions are available on General Services' Web site and are available for use by other state agencies. Further, General Services states that it has begun the process of reviewing DVBE program regulations to identify areas of improvement.

**Finding #7: The efficiency and effectiveness of the DVBE program could be improved with legislation aimed at providing incentives for DVBE participation and penalties for bidders who do not comply with program requirements.**

Legislation establishing the DVBE program does not have adequate provisions to ensure compliance with program goals.

To increase the efficiency and effectiveness of the DVBE program, we recommended the Legislature consider doing the following:

- Replace the current good-faith effort step requiring bidders to contact the federal government with a step directing bidders to contact General Services for a list of certified DVBEs.
- Enact a contracting preference for DVBEs similar to the one for the small business program—that is, allow an artificial downward adjustment to the bids from contractors that plan to use a DVBE to make the bids more competitive.
- Require awarding departments to go through their own good-faith effort in seeking DVBE contractors.
- Provide awarding departments with the authority to withhold a portion of the payments due to contractors when they fail to use DVBEs to the extent specified in their contracts.



***Legislative Action: None.***

We found no indication that the Legislature has passed legislation addressing the recommendations presented above.

# VETERANS HOME OF CALIFORNIA, YOUNTVILLE

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## ***Investigations of Improper Activities by State Employees, March 2002 Through July 2002***

ALLEGATION I2000-876 (REPORT I2002-2),  
NOVEMBER 2002

Department of Veterans Affairs' response as of August 2002<sup>1</sup>

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### ***Investigative Highlight . . .***

*The Veterans Home of  
California, Yountville,  
improperly billed Medicare  
\$55,000 for visits that the  
staff physician did not make.*

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**W**e investigated and substantiated that the information system used by the hospital at the Veterans Home of California, Yountville (home), for processing charges for services provided to the home's residents contains charges attributed to one doctor for services that the doctor could not have provided.

### **Finding: The home processed charges for services the doctor could not have provided.**

The information system the home uses to bill Medicare, Medi-Cal, and other insurers showed that one doctor saw patients 2,614 times from July 1, 1999, through July 17, 2001, but we concluded that the doctor did not see a patient in 1,792 (69 percent) of those visits. Some of these excess visits in the system were for patients who were not on the doctor's clinic schedule for that day. In 400 other cases, the doctor was not working on the day in question, including weekends, holidays, and days that she was on vacation or sick leave. Furthermore, 148 incorrectly recorded visits were on 50 days on which the doctor worked from home. As further evidence of the information system's lack of credibility, it indicated that the doctor saw patients on every day of 35 consecutive days spanning August and September 1999, 34 consecutive days spanning June and July 2000, and 26 consecutive days spanning May and June 2001. In fact, the billing system indicated that the doctor saw patients on all but three of the 70 days from July 15

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<sup>1</sup> Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2003, this is the date of the auditee's latest response.

through September 22, 1999. As of January 22, 2002, the home had billed Medicare \$131,000 for 1,488 of these 2,614 patient visits. However, \$55,000 was for 887 visits that we concluded the doctor did not make.

***Department Action: Pending.***

The Department of Veterans Affairs (department) reports that it is actively working to upgrade its billing system and is working with its billing agent to resolve any charges billed and reimbursed incorrectly. Further, the department states that it will ensure that it obtains the signature of the attending physician/technician to maintain proper practices and Medicare compliance.

# APPENDIX A

## Summary of Recommendations for Legislative Consideration by Policy Area

Table A.1 presents a summary of the recommendations the Bureau of State Audits directed to the Legislature from January 2002 through December 2003. Reports describing these recommendations are also identified in this table. For the status of the Legislature's actions with regards to these recommendations refer to the page number listed below.

TABLE A.1

### Recommendations Directed to the Legislature

Policy Area/Report Number and Title	Page	Recommendation
<b>Agriculture and Water Resources</b>		
<b>2000-016, Water Replenishment District of Southern California:</b> <i>Although the District Has Eliminated Excessive Water Rates, It Has Depleted Its Reserve Funds and Needs to Further Improve Its Administrative Practices</i>	13	We recommended, if restrictions on increasing assessment rates are extended past December 31, 2002, the Water Replenishment District of Southern California (district) should consider seeking legislative approval of statutory changes that will increase its flexibility to raise funds for its operations, capital improvement projects, and reserves.
	15	In addition, we recommend that the district continue to create an updated strategic plan and capital improvement plan to identify the programs and capital improvement projects that will aid it in fulfilling its mission.
<b>Appropriations</b>		
<b>2002-123.2, Federal Funds:</b> <i>The State of California Takes Advantage of Available Federal Grants, but Budget Constraints and Other Issues Keep It From Maximizing This Resource</i>	68	We recommended that as federal grants are brought up for reauthorization, the Legislature, in conjunction with the California congressional delegation, may wish to petition Congress to revise grant formulas that use out-of-date statistics to determine the share of grants awarded to the states.
	71	We also recommended that the Legislature may wish to ask departments to provide information related to the impact of federal program funding when it considers cuts in General Fund appropriations.
<b>2003-106, State Mandates:</b> <i>The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process</i>	80	We recommended that the Legislature direct the Commission to amend the parameters and guidelines of the animal adoption mandate to correct the formula for determining the reimbursable portion of acquiring additional shelter space. If the Commission amends these parameters and guidelines, the Controller should amend its claiming instructions accordingly and require local entities to amend claims already filed.

*continued on next page*

Policy Area/Report Number and Title	Page	Recommendation
<b>2003-107, California Department of Education: <i>The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them</i></b>	87	<p>We recommended that when the Legislature considers future reform proposals calling for the consolidation of categorical programs into block grants, it should ensure that proposals contain: accountability provisions that include a focus toward program results and outcomes; and allocation methods that reflect the recipient's need, ability to contribute to program costs, and cost of providing services.</p>
	89	<p>In addition, when the Legislature considers future reform proposals calling for the consolidation of categorical programs into block grants, we recommended that it should determine whether categorical programs involving federal programs are appropriate candidates for consolidation. Further, the Legislature should consider whether the reform proposal (1) is consistent with any legal restrictions that may apply to any particular funds and the State's constitutional obligation to provide equal educational opportunities within the public school system and (2) includes mechanisms by which the State can monitor and ensure that it meets those obligations. Finally, the Legislature should determine whether state or federal court decisions govern the funding of particular programs and ensure that block grant proposals continue to meet those mandates.</p>
	90	<p>Next, we recommended that if the Legislature concurs with California Department of Education's (CDE) exclusion of adult average daily attendance (ADA) when making allocations for the Targeted Instructional Improvement Grant Program (TIIG) program, it should enact language to clarify its definition of "total" ADA.</p>
	91	<p>Additionally, we recommended that if the Legislature desires CDE to properly calculate allocations the way the Legislature intends, it should define "regular" ADA for the California Public School Library Act program.</p>
	92	<p>We also recommended that if the Legislature continues to fund the School Improvement Programs in the annual budget and intends that CDE make adjustments to equalize the funding for schools with kindergarten through grade six using the same percentage increase made in base revenue limits for unified school districts with more than 1,500 ADA, it should enact language that provides CDE with specific instructions on how to compute the percentage increase.</p>
	93	<p>If the Legislature continues to fund the Miller-Unruh Basic Reading Act program in the annual budget, we recommended that it should ensure that CDE allocates Miller-Unruh reading specialist positions in a manner that gives first priority to school districts with underperforming schools and the lowest base revenue limits. Further, it should ensure that CDE reallocates unused positions in the following fiscal year.</p>
	96	<p>Finally, we recommended that if the Legislature intends CDE to provide oversight for TIIG, it should enact language specifically requiring CDE to do so. It should also enact language to define the term "lowest achieving pupils in the district."</p>

Policy Area/Report Number and Title	Page	Recommendation
<b>Business and Professions and Governmental Organization</b>		
<b>2001-128, Enterprise Licensing Agreement: <i>The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars</i></b>	113	We recommended that the Legislature consider requiring all Information Technology contracts over a specified dollar amount to receive a legal review by the Department of General Services.
<b>2002-107, Office of Criminal Justice Planning: <i>Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery</i></b>	129	To improve the efficiency of the State's domestic violence programs and reduce overlap of Office of Criminal Justice Planning's (OCJP) and Department of Health Services' (DHS) administrative activities, we recommended OCJP and DHS, along with the Legislature, should consider implementing one of the following alternatives: <ul style="list-style-type: none"> <li>• Increase coordination between the departments.</li> <li>• Develop a joint grant application for the two departments' shelter-based programs.</li> <li>• Combine the two shelter-based programs at one department.</li> <li>• Completely consolidate all OCJP's and DHS's domestic violence programs.</li> </ul>
<b>2002-110, California State University: <i>Its Common Management System Has Higher Than Reported Costs, Less Than Optimal Functionality, and Questionable Procurement and Conflict-of-Interest Practices</i></b>	150	To ensure that California State University (university) takes appropriate action to prevent potential conflicts of interest in the future, the Legislature should consider requiring the university to provide periodic ethics training to designated university employees similar to that required by Government Code for designated state employees. Additionally, the Legislature should consider requiring the university to establish an incompatibles activities policy for university employees similar to that addressed in Government Code, Section 19990.
<b>2002-112, Statewide Procurement Practices: <i>Proposed Reforms Should Help Safeguard State Resources, but the Potential for Misuse Remains</i></b>	161	The Department of General Services should seek a change in the current contracting and procurement laws if it wants to continue to exempt purchases from competitive bidding requirements because of special or unique circumstances.
<b>2002-122, State Controller's Office: <i>Does Not Always Ensure the Safekeeping, Prompt Distribution, and Collection of Unclaimed Property</i></b>	174	To eliminate the State Controller's Office (controller) Bureau of Unclaimed Property's manual tracking of securities and dispel any impressions that it exercises judgment in deciding when is the best time to sell securities, thereby reducing the potential for errors, eliminating unnecessary work, and reducing the potential for litigation against the State, the controller should seek legislation to require it to sell securities immediately upon receipt.
<b>Education</b>		
<b>2001-120, School Bus Safety II: <i>State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected</i></b>	212	We recommended the Legislature amend the parameters and guidelines of the School Bus Safety II mandate through legislation to more clearly define activities that are reimbursable and to ensure that those activities reflect what the Legislature intended. The parameters and guidelines should clearly delineate between activities that are required under prior law and those that are required under the mandate.

*continued on next page*

Policy Area/Report Number and Title	Page	Recommendation
<b>2002-104, California's Charter Schools: Oversight at All Levels Could Be Stronger to Ensure Charter Schools' Accountability</b>	239	To ensure that the chartering entities hold their charter schools accountable through oversight, the Legislature should consider amending the statute to make the chartering entities' oversight role and responsibilities explicit.
	245	In addition, to ensure that the chartering entities charge their oversight fees appropriately, the Legislature should consider clarifying the law to define the types of charter school revenues that are subject to the chartering entities' oversight fees.
	249	Finally, to ensure that a charter school's assets and liabilities are disposed of properly when it closes or its charter is revoked, the Legislature may wish to consider establishing a method for disposing of the school's assets and liabilities and requiring the California Department of Education to adopt regulations regarding this process.
<b>2002-110, California State University: Its Common Management System Has Higher Than Reported Costs, Less Than Optimal Functionality, and Questionable Procurement and Conflict-of-Interest Practices</b>		This audit is also included in the Business and Professions and Governmental Organization policy area. See that policy area for the wording of our recommendation.
<b>2003-107, California Department of Education: The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them</b>		This audit is also included in the Appropriations policy area. See that policy area for the wording of our recommendation.
<b>2002-032, California's Education Institutions: A Lack of Guidance Results in Their Inaccurate or Inconsistent Reporting of Campus Crime Statistics</b>	252	<p>To provide additional guidance to California education institutions for complying with the Clery Act, the Legislature should consider creating a task force to perform the following functions:</p> <ul style="list-style-type: none"> <li>• Compile a comprehensive list converting crimes defined in California's laws to Clery Act reportable crimes.</li> <li>• Issue guidance to assist institutions in defining campus, noncampus, and public property locations, including guidelines for including or excluding crimes occurring at other institutions.</li> <li>• Obtain concurrence from the United States Department of Education on all agreements reached.</li> <li>• Evaluate the pros and cons of establishing a governing body to oversee institutions' compliance with the Clery Act.</li> </ul>
<b>Environmental Safety and Quality and Toxic Materials</b>		
<b>2002-121, California Environmental Protection Agency: Insufficient Data Exists on the Number of Abandoned, Idled, or Underused Contaminated Properties, and Liability Concerns and Funding Constraints Can Impede Their Cleanup and Redevelopment</b>	277	We recommended that to obtain a comprehensive listing of the number of orphan sites and sites with orphan shares, the Legislature should consider requiring the California Environmental Protection Agency and its entities to capture necessary data in their existing or new databases.
<b>2003-113, California Integrated Waste Management Board: Its New Regulations Establish Rules for Oversight of Construction and Demolition Debris Sites, but Good Communication and Enforcement Are Also Needed to Help Prevent Threats to Public Health and Safety</b>	287	We recommended that the Legislature may wish to consider amending the current provisions of the Waste Act that allow a stay of an enforcement order upon the request for a hearing, and to streamline or otherwise modify the appeal process to make it more effective and timely and enhance the ability to enforce the Waste Act.

Policy Area/Report Number and Title	Page	Recommendation
<b>Health and Human Services</b>		
<b>2001-126, Department of Managed Health Care:</b> <i>Assessments for Specialized and Full-Service HMOs Do Not Reflect Its Workload and Have Disparate Financial Impacts</i>	306	We recommended that the Legislature consider changing the Department of Managed Health Care's (department) assessment structure to reflect the proportion of the documented workload that the department devotes to specialized and full-service health maintenance organizations (HMOs) and to reduce disparities in the financial effect on HMOs. We also recommended that the Legislature require the department to report to it triennially on the proportion of assessments charged to each class of HMO and the proportion of the documented workload related to each class of HMO.
<b>2002-107, Office of Criminal Justice Planning:</b> <i>Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery</i>		This audit is also included in the Business and Professions and Governmental Organization policy area. See that policy area for the wording of our recommendation.
<b>2001-015, Statewide Fingerprint Imaging System:</b> <i>The State Must Weigh Factors Other Than Need and Cost-Effectiveness When Determining Future Funding for the System</i>	332	The Legislature should consider the pros and cons of repealing the state law requiring fingerprint imaging, including whether the Statewide Fingerprint Imaging System (SFIS) is consistent with the State's community outreach and education campaign efforts for the Food Stamp program. To assist the Legislature in its consideration of the pros and cons of repealing the state law that requires fingerprint imaging, the Department of Social Services and the Health and Human Services Agency Data Center should report on the full costs associated with discontinuing SFIS.
<b>2003-113, California Integrated Waste Management Board:</b> <i>Its New Regulations Establish Rules for Oversight of Construction and Demolition Debris Sites, but Good Communication and Enforcement Are Also Needed to Help Prevent Threats to Public Health and Safety</i>		This audit is also included in the Environmental Safety and Quality and Toxic Materials policy area. See that policy area for the wording of our recommendation.
<b>2003-112, Department of Health Services:</b> <i>It Needs to Better Plan and Coordinate Its Medi-Cal Antifraud Activities</i>	380	To ensure that the Department of Health Services and the Department of Justice promptly complete their negotiations for a current agreement that would assist both in communicating and coordinating their respective roles and responsibilities for investigating, referring, and prosecuting cases of suspected Medi-Cal provider fraud, we recommended that the Legislature consider requiring both agencies to report the status of the required agreement during budget hearings.
<b>Information Technology</b>		
<b>2001-128, Enterprise Licensing Agreement:</b> <i>The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars</i>		This audit is also included in the Business and Professions and Governmental Organization policy area. See that policy area for the wording of our recommendation.
<b>2002-110, California State University:</b> <i>Its Common Management System Has Higher Than Reported Costs, Less Than Optimal Functionality, and Questionable Procurement and Conflict-of-Interest Practices</i>		This audit is also included in the Business and Professions and Governmental Organization policy area. See that policy area for the wording of our recommendation.
<b>Insurance</b>		
<b>2001-126, Department of Managed Health Care:</b> <i>Assessments for Specialized and Full-Service HMOs Do Not Reflect Its Workload and Have Disparate Financial Impacts</i>		This audit is also included in the Health and Human Services policy area. See that policy area for the wording of our recommendation.

continued on next page

Policy Area/Report Number and Title	Page	Recommendation
<b>Jobs, Economic Development, and the Economy</b>		
<b>Report Number 2003-108.1, California's Workers' Compensation Program: <i>The Medical Payment System Does Not Adequately Control the Costs to Employers to Treat Injured Workers or Allow for Adequate Monitoring of System Costs and Patient Care</i></b>	385	We recommended that to ensure future legislation does not contain any unintended impediments to the improvement of the workers' compensation system, the administrative director should be proactive in working with the Legislature to identify and amend any provisions that would adversely affect the administrative director's ability to effect changes.
	389	Also, to ensure that the treatment guidelines can serve as an authoritative standard for the treatment of workers' injuries, we recommended that the administrative director should seek the changes necessary in the Labor Code to ensure that all insurers and claims administrators are required to follow the standardized treatment guidelines and that treatment guidelines are accepted for use in judicial proceedings.
<b>Judiciary</b>		
<b>2002-030, State Bar of California: <i>Although It Reasonably Sets and Manages Mandatory Fees, It Faces Potential Deficits in the Future and Needs to More Strictly Enforce Disciplinary Policies and Procedures</i></b>	398	We recommended that the State Bar of California pursue a legislative amendment that would help it strengthen its enforcement authority over collections related to client security and disciplinary costs.
<b>Labor, Employment, and Industrial Relations</b>		
<b>Report Number 2003-108.1, California's Workers' Compensation Program: <i>The Medical Payment System Does Not Adequately Control the Costs to Employers to Treat Injured Workers or Allow for Adequate Monitoring of System Costs and Patient Care</i></b>		This audit is also included in the Jobs, Economic Development, and the Economy policy area. See that policy area for the wording of our recommendation.
<b>Local Government</b>		
<b>2000-016, Water Replenishment District of Southern California: <i>Although the District Has Eliminated Excessive Water Rates, It Has Depleted Its Reserve Funds and Needs to Further Improve Its Administrative Practices</i></b>		This audit is also included in the Agriculture and Water Resources policy area. See that policy area for the wording of our recommendation.
<b>2001-120, School Bus Safety II: <i>State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected</i></b>		This audit is also included in the Education policy area. See that policy area for the wording of our recommendation.
<b>2001-125, Red Light Camera Programs: <i>Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level</i></b>	408	We recommended that to ensure local governments maintain control and operate their red light camera programs and avoid legal challenge, the Legislature should consider clarifying the law to define the tasks that a local government must perform to operate a red light camera program and the tasks that can be delegated to a vendor.
	412	Further, because a potential conflict exists between the confidentiality provision in the Vehicle Code and the California Constitution regarding the admissibility of evidence, the Legislature should consider clarifying the Vehicle Code to state whether photographs taken by red light cameras can be used for other law enforcement purposes.
<b>2003-106, State Mandates: <i>The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process</i></b>		This audit is also included in the Appropriations policy area. See that policy area for the wording of our recommendation.
<b>2003-107, California Department of Education: <i>The Extensive Number and Breadth of Categorical Programs Challenges the State's Ability to Reform and Oversee Them</i></b>		This audit is also included in the Appropriations policy area. See that policy area for the wording of our recommendation.

Policy Area/Report Number and Title	Page	Recommendation
<b>Privacy and Public Safety</b>		
<b>2001-125, Red Light Camera Programs:</b> <i>Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level</i>		This audit is also included in the Local Government policy area. See that policy area for the wording of our recommendation.
<b>Revenue and Taxation</b>		
<b>2002-122, State Controller's Office:</b> <i>Does Not Always Ensure the Safekeeping, Prompt Distribution, and Collection of Unclaimed Property</i>		This audit is also included in the Business and Professions and Governmental Organization policy area. See that policy area for the wording of our recommendation.
<b>2002-126, California Department of Transportation:</b> <i>Low Cash Balances Threaten the Department's Ability to Promptly Deliver Planned Transportation Projects</i>	458	We recommended that, considering the State's fiscal crisis, the Legislature may wish to allow the Transportation Investment Fund to transfer the entire \$678 million to the Traffic Congestion Relief Fund (TCRF), and then authorize a loan of the money from the TCRF to the General Fund so that those funds would be repaid to the TCRF and therefore still be available in future years.
<b>Transportation</b>		
<b>2001-120, School Bus Safety II:</b> <i>State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected</i>		This audit is also included in the Education policy area. See that policy area for the wording of our recommendation.
<b>2001-125, Red Light Camera Programs:</b> <i>Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level</i>		This audit is also included in the Local Government policy area. See that policy area for the wording of our recommendation.
<b>2002-103, California Department of Transportation:</b> <i>It Manages the State Highway Operation and Protection Program Adequately, but It Can Make Improvements</i>	461	To ensure that the California Department of Transportation (Caltrans) can collect on a performance bond if a contractor does not perform, we recommended that the Legislature consider expanding Caltrans' ability to use other financial indicators included within the financial statements and information available from rating companies such as A.M. Best Company and S&P as a basis for determining the sufficiency of an insurer, before accepting performance bonds. Further, the Legislature should clarify Caltrans' authority to use the information it obtains from financial statements and other financial indicators to object to the sufficiency of an insurer throughout the bond term.
<b>2002-126, California Department of Transportation:</b> <i>Low Cash Balances Threaten the Department's Ability to Promptly Deliver Planned Transportation Projects</i>		This audit is also included in the Revenue and Taxation policy area. See that policy area for the wording of our recommendation.
<b>Veterans Affairs</b>		
<b>2001-127, Disabled Veteran Business Enterprise Program:</b> <i>Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success</i>	467	To determine if the 3 percent Disabled Veteran Business Enterprise (DVBE) goal is reasonable, the Legislature may wish to consider requiring either Department of General Services (General Services) or Department of Veterans Affairs (Veterans Affairs) to commission a study on the potential number of DVBE-eligible firms in the State, the services they provide, and their geographic distribution, and compare this information to the State's contracting needs. Based on the results of this study, the Legislature may wish to consider doing the following: <ul style="list-style-type: none"> <li>• Modify the current DVBE participation goal.</li> <li>• Allow General Services to negotiate department-specific goals based on individual contracting needs and the ability of the current or potential DVBE pool to satisfy those needs.</li> </ul>

*continued on next page*

Policy Area/Report Number and Title	Page	Recommendation
	471	Also, to ensure that prime contractors make a genuine good-faith effort to find a DVBE, we recommended the Legislature consider requiring awarding departments to follow General Services' policies.
	472	<p>Finally, to increase the efficiency and effectiveness of the DVBE program, we recommended the Legislature consider doing the following:</p> <ul style="list-style-type: none"> <li>• Replace the current good-faith step requiring bidders to contact the federal government with a step directing bidders to contact General Services for a list of certified DVBEs.</li> <li>• Enact a contracting preference for DVBEs similar to the one for the small business program – that is, allow an artificial download adjustment to the bids from contractors that plan to use a DVBE to make the bids more competitive.</li> <li>• Require awarding departments to go through their own good-faith effort in seeking DVBE contractors.</li> <li>• Provide awarding departments with the authority to withhold a portion of the payments due to contractors when they fail to use DVBEs to the extent specified in their contracts.</li> </ul>

# APPENDIX B

## **Summary of Monetary Benefits Identified In Audit Reports Released From July 1, 2001, Through December 31, 2003**

We estimate that auditees could have realized more than \$441 million of monetary benefits during the period July 1, 2001, through December 31, 2003, if they implemented our recommendations. Table B.1 provides a brief description of the monetary benefits we found such as cost recoveries, cost savings, and increased revenues. Finally, many of the monetary benefits we have identified are not only one-time benefits; they are monetary benefits that could be realized each year for many years to come.

**TABLE B.1**

### **Monetary Benefits July 1, 2001, Through December 31, 2003**

<b>Audit Number/ Date Released</b>	<b>Audit Title/Basis of Benefit</b>	<b>Monetary Benefit</b>
<b>July 1, 2001, Through June 30, 2002</b>		
2001-102 (July 2001)	<b>Department of Insurance Conservation and Liquidation Office: Stronger Oversight Is Needed to Properly Safeguard Insurance Companies' Assets</b>  <i>Cost savings and cost recovery</i> —Recovery of overpayment to a contractor for \$43,000 and recovery of reinsurance not yet billed at \$1,385,000. In addition, cost savings of \$300,000 under CLO's new contract with its investment managers, which will recur for many years. The CLO reported that it recovered the overpayment as of December 21, 2001.	\$1,728,000
2001-107 (October 2001)	<b>Port of Oakland: Despite Its Overall Financial Success, Recent Events May Hamper Expansion Plans That Would Likely Benefit the Port and the Public</b>  <i>Increased revenue</i> —If the real estate division were to renegotiate its below-market leases to approximately 25 percent of their aggregate estimated fair market value, it could increase annual revenues. In 2002, three of the Port's below-market leases expired. If the Port renegotiated these leases to 25 percent of market value, the Port would realize over \$7.5 million annually.	7,500,000
2001-108 (November 2001)	<b>California Department of Corrections: Its Fiscal Practices and Internal Controls Are Inadequate to Ensure Fiscal Responsibility</b>  <i>Cost savings and cost recovery</i> —Recover \$24,000 of overpayment on overhead, save \$150,000 of future overhead costs through fiscal year 2002–03, save \$733,000 by eliminating unneeded contractor, which will recur for many years, and save \$42 million spent on overtime by filing vacant positions, which will recur for many years. We estimate that savings for fiscal year 2002–03 could be \$883,000 (\$150,000 plus \$733,000) and savings of \$733,000 annually for periods thereafter. However, since it may take CDC a few years to fill its vacant positions, it is not unreasonable to expect CDC to incrementally realize overtime cost savings over a five-year period starting in fiscal year 2001–02.	907,000

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Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit
2001-120 (March 2002)	<b>School Bus Safety II:</b> <i>State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected</i>	\$235,800,000
	<u>Cost savings</u> —We recommended that the Legislature clarify what activities are reimbursable. In 2002, the Legislature passed Assembly Bill 2781, which specifies that costs associated with implementation of transportation plans are not reimbursable claims. Costs for a six-year period ending June 30, 2002, were \$235.8 million and the ongoing costs after June 30, 2002, are \$44.3 million each year thereafter.	
2001-128 (April 2002)	<b>Enterprise Licensing Agreement:</b> <i>The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars</i>	*
	<u>Cost savings</u> —The State and Oracle agreed to rescind the contract in July 2002. As a result, we estimate the State will save \$8,120,000 per year for five years starting in fiscal year 2002–03.	
2001-116 (April 2002)	<b>San Diego Unified Port District:</b> <i>It Should Change Certain Practices to Better Protect the Public’s Interests in Port-Managed Resources</i>	*
	<u>Increased revenue</u> —We estimate an increase in revenue of \$700,000 per year by obtaining market value rents. This monetary benefit will recur for many years, however, it is not anticipated to begin until 2007.	
2001-124 (June 2002)	<b>Los Angeles Unified School District:</b> <i>Outdated, Scarce Textbooks at Some Schools Appear to Have a Lesser Effect on Academic Performance Than Other Factors, but the District Should Improve Its Management of Textbook Purchasing and Inventory</i>	1,762,000
	<u>Cost savings</u> —We found that some publishers are not equitably providing free instructional materials (commonly referred to as gratis items) to different schools within LAUSD, as state law requires. Subsequently, LAUSD reports that it negotiated with publishers and thus far one publisher has actually provided approximately \$300,000 in gratis items.	
<b>Total for July 1, 2001, Through June 30, 2002</b>		<b>\$247,697,000</b>
<b>July 1, 2002, Through June 30, 2003</b>		
2001-123 (July 2002)	<b>Deaf and Disabled Telecommunications Program:</b> <i>Insufficient Monitoring of Surcharge Revenues Combined With Imprudent Use of Public Funds Leave Less Money Available for Program Services</i>	\$268,000
	<u>Cost savings</u> —Represents \$200,000 in known unremitted collections from intrastate telecommunication charges and \$68,000 in penalties and interest due for 2000 and 2001.	
2002-101 (July 2002)	<b>California Department of Corrections:</b> <i>A Shortage of Correctional Officers, Along With Costly Labor Agreement Provisions, Raises Both Fiscal and Safety Concerns and Limits Management’s Control</i>	*
	<u>Cost savings</u> —We estimate the department could save \$58 million if it reduces overtime costs by filling unmet correctional officer needs. This estimate includes the \$42 million we identified in our November 2001 report (2001-108). The department stated in its six-month response to this audit that, following our recommendation to increase the number of correctional officer applicants, it has submitted a proposal to restructure its academy to allow two additional classes each year. This action could potentially allow the department to graduate several hundred more correctional officers each year, thereby potentially contributing to a reduction in its overtime costs. However, any savings from this action would be realized in future periods.	
2002-107 (October 2002)	<b>Office of Criminal Justice Planning:</b> <i>Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery</i>	23,000
	<u>Cost savings</u> —Represents estimated annual savings from the elimination of duplicative work conducted by the State Controller’s Office. This savings would recur indefinitely.	

Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit																		
2002-109 (December 2002)	<b>Department of Health Services:</b> <i>It Needs to Better Control the Pricing of Durable Medical Equipment and Medical Supplies and More Carefully Consider Its Plans to Reduce Expenditures on These Items</i>	\$ 911,000																		
	<u>Cost savings</u> —Represents savings the department would have achieved in fiscal year 2002–03 had it updated its maximum price for blood glucose test strips and volume remained the same as it was in the previous fiscal year. Also, beginning in fiscal year 2003–04, the department could save an additional \$2.7 million annually if it purchases stationary volume ventilators instead of renting them. However, because this action has not taken place, we are not adding the \$2.7 million to the monetary benefits estimate.																			
2002-009 (April 2003)	<b>California Energy Markets:</b> <i>The State's Position Has Improved, Due to Efforts by the Department of Water Resources and Other Factors, but Cost Issues and Legal Challenges Continue</i>	29,000,000																		
	<u>Cost savings</u> —In response to an audit recommendation, the department renegotiated certain energy contracts. The department's consultant estimates that the present value of the potential cost savings due to contract renegotiation efforts as of December 31, 2002, by the department and power suppliers, when considering replacement power costs, to be \$580 million. For the purpose of this analysis, we have computed the average annual cost savings by dividing the \$580 million over the 20-year period the savings will be realized. The estimated savings totaling \$580 million over 20 years varies by year from approximately -\$130 million to +\$180 million.																			
	Annualized carry forward from prior fiscal years:	64,103,000																		
	<table border="0"> <tr> <td>2000-134.2</td> <td>Energy Deregulation†</td> <td>\$ 3,000,000</td> </tr> <tr> <td>2001-102</td> <td>Department of Insurance Conservation and Liquidation Office</td> <td>300,000</td> </tr> <tr> <td>2001-107</td> <td>Port of Oakland</td> <td>7,500,000</td> </tr> <tr> <td>2001-108</td> <td>California Department of Corrections</td> <td>883,000</td> </tr> <tr> <td>2001-120</td> <td>School Bus Safety II</td> <td>44,300,000</td> </tr> <tr> <td>2001-128</td> <td>Enterprise Licensing Agreement</td> <td>8,120,000</td> </tr> </table>	2000-134.2	Energy Deregulation†	\$ 3,000,000	2001-102	Department of Insurance Conservation and Liquidation Office	300,000	2001-107	Port of Oakland	7,500,000	2001-108	California Department of Corrections	883,000	2001-120	School Bus Safety II	44,300,000	2001-128	Enterprise Licensing Agreement	8,120,000	
2000-134.2	Energy Deregulation†	\$ 3,000,000																		
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2001-108	California Department of Corrections	883,000																		
2001-120	School Bus Safety II	44,300,000																		
2001-128	Enterprise Licensing Agreement	8,120,000																		
	Subtotal	\$64,103,000																		
<b>Total for July 1, 2002, Through June 30, 2003</b>		<b>\$94,305,000</b>																		
<b>July 1, 2003, Through December 31, 2003</b>																				
2002-121 (July 2003)	<b>California Environmental Protection Agency:</b> <i>Insufficient Data Exists on the Number of Abandoned, Idled, or Underused Contaminated Properties, and Liability Concerns and Funding Constraints Can Impede Their Cleanup and Redevelopment</i>	1,000,000																		
	<u>Increased revenue</u> —CalEPA would have received up to an additional \$1 million in revenues if it had applied for a one-time federal grant.																			
2003-106 (October 2003)	<b>State Mandates:</b> <i>The High Level of Questionable Costs Claimed Highlights the Need for Structural Reforms of the Process</i>	4,800,000																		
	<u>Cost savings</u> —If the local entities we audited file corrected claims for the errors we identified, the State will save \$4.8 million (\$4.1 million related to the Peace Officers Procedural Bill of Rights mandate and \$675,000 related to the Animal Adoption mandate). We also recommended that the State Controller's Office audit the Peace Officers Procedural Bill of Rights claims that have been filed. We believe that such audits could yield savings of up to \$159.6 million.																			
2003-102 (December 2003)	<b>Water Quality Control Boards:</b> <i>Could Improve Their Administration of Water Quality Improvement Projects Funded by Enforcement Actions</i>	301,000																		
	<u>Increased revenue</u> —We identified 92 violations that require fine issuance and collection of the fines and three fines that were issued but not collected. The board could increase its revenue if it collected these fines.																			

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Audit Number/ Date Released	Audit Title/Basis of Benefit	Monetary Benefit
	Annualized carry forward from prior fiscal years:	\$ 92,976,000
2000-134.2	Energy Deregulation	\$ 3,000,000
2001-102	Department of Insurance Conservation and Liquidation Office	300,000
2001-107	Port of Oakland	7,500,000
2001-108	California Department of Corrections	733,000
2001-120	School Bus Safety II	44,300,000
2001-128	Enterprise Licensing Agreement	8,120,000
2002-107	Office of Criminal Justice Planning	23,000
2002-009	California Energy Markets	29,000,000
	Subtotal	\$92,976,000
<b>Totals for July 1, 2003, Through December 31, 2003</b>		<b>\$98,077,000</b>
<b>Totals for July 1, 2001, Through June 30, 2003</b>		<b>\$342,002,000</b>
<b>Totals for July 1, 2001, Through December 31, 2003</b>		<b>\$440,079,000</b>

\* Although this listing identified monetary benefits the auditee could reasonably expect to realize if it implements our recommendations, these benefits would not be realized in the period covered in this listing. Therefore, the appropriate amounts will be included in future years.

† We issued report 2000-134.2 on Energy Deregulation in May 2001. Cost savings is from the annual maintenance cost of a Web site that we recommended be eliminated because it is not needed. This cost savings will recur for many years.

# INDEX

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## ***State and Local Entities With Recommendations From Audits Included in This Special Report***

### State Entities

---

State Bar of California	395
Business, Transportation and Housing Agency	463
Commission on State Mandates	75, 211
State Controller's Office	49, 75, 169, 211
Corrections, Department of	289, 425
Courts, Administrative Office of the	45
Criminal Justice Planning, Office of	119
Developmental Services, Department of	439
Education, Department of	85, 217 237
Emergency Services, Office of	181, 189, 431
California Environmental Protection Agency	39, 275
Finance, Department of	49, 67, 107
Fish and Game, Department of	441, 463
Franchise Tax Board	57
General Services, Department of	107, 131, 153, 289, 463
Health Services, Department of	67, 119, 297, 317, 335, 369, 463
Health and Human Services Agency	463
Health and Human Services Agency Data Center	167
Homeland Security, Office of	189
Industrial Relations, Department of	25, 383, 435
Information Technology, Department of	107
California Integrated Waste Management Board	279
Justice, Department of	197, 369
Managed Health Care, Department of	305
Mental Health, Department of	49
California National Guard	99, 189
California Postsecondary Education Commission	251
Public Utilities Commission	257, 267, 451
Rehabilitation, Department of	309
Resources Agency	463

Social Services, Department of	325, 355
State and Consumer Services Agency	57, 115, 463
Teale Data Center, Stephen P.	153
Toxic Substances Control, Department of	275
California Transportation Commission	455
Transportation, Department of	449, 455, 459, 463
California Unemployment Insurance Appeals Board	445
California State University	137, 251
University of California	207, 229, 251
California Veterans Board	3
Veterans Affairs, Department of	3, 463, 473
State Water Resources Control Board	39, 275
Water Resources, Department of	29
Youth and Adult Correctional Agency	463

#### Local Entities

---

Ceres Unified School District	211
Charter Schools, Various	237
Dinuba Unified School District	211
Elk Grove Unified School District	211
Fremont, City of	407
Fresno, City and County of	279
Fresno Unified School District	211
Long Beach, City of	407
Los Angeles, City and County of	75
Los Angeles County	407
Los Angeles County Metropolitan Transportation Authority	419
Los Angeles Unified School District	217
Oxnard, City of	407
Sacramento, City of	407
Sacramento, City and County of	279
San Diego, City of	75, 407
San Diego Unified Port District	401
San Dieguito Union High School District	211
San Francisco, City and County of	75, 407

San Jose, City of	75
Stockton, City of	75
Water Replenishment District of Southern California	9

cc: Members of the Legislature  
Office of the Lieutenant Governor  
Milton Marks Commission on California State  
Government Organization and Economy  
Department of Finance  
Attorney General  
State Controller  
State Treasurer  
Legislative Analyst  
Senate Office of Research  
California Research Bureau  
Capitol Press