Cannabis Business Licensing

Inadequate Oversight and Inappropriate Expenditures Weaken the Local Jurisdiction Assistance Grant Program

August 2024

REPORT 2023-048

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Grant Parks *State Auditor*

Mike Tilden *Chief Deputy*

August 29, 2024
2023-048

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

State law requires my office to conduct a performance audit of the local jurisdictions that received funds as part of the Local Jurisdiction Assistance Grant Program (Grant Program). State law also requires the Department of Cannabis Control (DCC) to administer the Grant Program, which we also audited. In general, we determined that DCC's inadequate oversight and the local jurisdictions' inappropriate expenditures during the first year of the Grant Program have weakened the program's ability to achieve its purpose, which is to assist certain local jurisdictions needing assistance in transitioning cannabis businesses that hold provisional licenses to obtain annual state licenses.

Although the 17 local jurisdictions that received grant funds (grantees) were able to transition about 530 provisional licenses to annual state licenses, the grantees still had more than 4,600 provisional licenses that needed to transition as of January 1, 2023. Several factors contributed to the grantees' slow progress, including their limited spending of grant funds in the program's first year and DCC's continued issuance of provisional licenses through September 2022. Moreover, DCC has not tracked key steps in its licensing process that would have allowed it to identify and address whether delays resulted from applicants, local jurisdictions, or its own processes.

Although DCC took steps to improve its administration of the Grant Program after we communicated concerns to its leadership in July 2023, some shortcomings in DCC's grant management practices remain unresolved. For example, DCC cannot accurately measure whether the 17 grantees are on track to accomplish the purpose of the Grant Program because DCC did not ensure that they provided clear goals or measurable benchmarks. DCC also did not obtain documents from grantees that would have revealed problems with their expenditures. As a result, two grantees reported to DCC $26,000 in costs that we questioned because they could not substantiate that all of their grant fund spending was appropriate.

Respectfully submitted,

GRANT PARKS
California State Auditor

Selected Abbreviations Used in This Report

CEQA	California Environmental Quality Act
DCC	Department of Cannabis Control
GFOA	Government Finance Officers Association
OGM	Office of Grant Management

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Summary

Results in Brief

California voters in November 2016 legalized the nonmedical personal use of cannabis for adults 21 years of age or older.[1] Under California law, cannabis businesses must generally obtain an annual state license to operate legally. The State initially issued provisional licenses to encourage cannabis businesses to transition into the newly state-regulated market. However, most provisional licenses will no longer be effective after January 2026.[2] To continue operating legally under California law after that date, provisional license holders must obtain an annual state license. The 2021 Budget Act appropriated $100 million for the Local Jurisdiction Assistance Grant Program (Grant Program) to assist 17 selected local jurisdictions (grantees) in helping provisional license holders that need the greatest assistance in obtaining an annual state license. Grantees must expend or encumber the grant funds before June 30, 2025. The Department of Cannabis Control (DCC) administers the Grant Program and issues provisional and annual state licenses.

DCC Did Not Appropriately Oversee the Grant Program

DCC's management of the Grant Program did not follow certain best practices in grant administration. For example, it did not ensure that grantees provide measurable benchmarks for each goal in their grant agreements. As a result, DCC could not measure grantees' progress toward their goals, and in four instances, the grant agreements that DCC approved did not include goals against which to measure progress. DCC also did not establish sufficient monitoring of grantees' expenditures or request documentation for those expenditures. Consequently, DCC has not obtained documentation that would have revealed problems with the grantees' expenditures, including unallowable and underreported costs.

DCC also did not establish benchmarks for the Grant Program itself, to accurately measure whether the Grant Program is on track to accomplish its purpose, and DCC did not initially establish a spending plan for its administrative funds. Consequently, DCC has spent just $350,000 of the $5 million it has to administer the program, has understaffed the program with staff who are underqualified to manage a program of this complexity, and has not responded to grantees' amendment requests in a timely manner. After we informed DCC through a July 2023 management letter about its staffs' inexperience and the other problems that we identified in its grant management and use of administrative funds, DCC took immediate action to address some of these issues. However, as of May 2024, other issues with DCC's grant management practices remain unresolved.

1 The nonmedical personal use of marijuana (cannabis) is still illegal under federal law.

2 The State has used both temporary licenses and provisional licenses. For the purposes of this report, we refer to temporary and provisional licenses as *provisional licenses*.

Some Grantees Did Not Manage Their Grant Funds Properly

We determined that some grantees' processes for managing the awarded funds did not align with best practices. We found that not all grantees adequately tracked their expenditures and documented whether staff time charged to the Grant Program was spent on tasks related to the program. By not adequately tracking expenditures, grantees hindered DCC's ability to track their spending. We also identified $26,000 in costs we questioned because two grantees could not substantiate that the spending was appropriate.

The Grant Program May Not Achieve Its Goals, and DCC Cannot Determine the Causes of Delays in License Processing

As of January 1, 2023—the end of the Grant Program's first year—more than 4,600 provisional license holders in the 17 grantees' jurisdictions still needed to obtain annual state licenses. During the first year of the Grant Program, the average rate at which provisional license holders in the grantees' jurisdictions were obtaining annual state licenses did not increase from the prior year's rate. We selected six grantees for further review and identified several factors that contributed to the grantees' slow progress in helping provisional license holders transition to annual state licenses. These factors include limited spending of grant funds in the first year and, in the case of one grantee, delays in changing the application process by which cannabis businesses could transition from provisional licenses to annual state licenses. In addition, despite experiencing license processing times that average two years, DCC did not track key steps in its licensing process. Such tracking would have allowed DCC to analyze those steps that contribute most to delays and identify solutions to mitigate delays in its process. The lack of data and documentation on when steps in the application process are completed prevented us from analyzing the potential causes for delays in processing times.

Agency Comments

DCC agreed or partially agreed with most of the recommendations we made and stated concerns or offered additional perspective on several of our conclusions. However, DCC disagreed with our recommendation to give grantees more time to spend grant funds because it believes doing so would inhibit its ability to close out the Grant Program in a timely manner. Of the four local jurisdictions to which we made recommendations, the city of Long Beach agreed with our recommendation and the city of San Diego offered the perspective that it had repaid the $6,000 in misspent funds that we identified. The city of Commerce and the county of Humbolt chose not to submit a response.

Introduction

Background

In November 2016, California legalized the nonmedical personal use of marijuana (cannabis) for adults 21 years of age or older.[3] During the 2022 calendar year, taxable sales of cannabis in California totaled $5.4 billion. Under California law, cannabis businesses must generally comply with local cannabis permitting processes and obtain a license from the State to operate legally. The State initially issued provisional licenses to encourage cannabis businesses to transition into the newly regulated market. Provisional licenses are only valid for up to 12 months, but DCC may renew a provisional license, subject to certain requirements, until DCC issues or denies an annual state license. As a condition for holding a provisional license, the licensee must actively apply for and pursue an annual state license.

The State continues to issue provisional licenses to a subset of cannabis businesses—local retail equity applicants—but no longer issues provisional licenses otherwise. To obtain a provisional license, applicants must generally meet certain requirements. First, they must comply with any local cannabis permitting processes in their respective jurisdictions or submit evidence that compliance is underway. Because state law grants local control to individual jurisdictions, the jurisdictions generally may choose the extent of their restrictions: for example, they may decide not to allow any type of cannabis businesses to operate, they may issue permits for only certain types of cannabis businesses, or they may set limits on the number of cannabis businesses that may operate within their boundaries.[4] Local jurisdictions also assess and set fees for their permitting processes, annually renew permits, and may perform on-site inspections of cannabis businesses.

In addition to satisfying local jurisdiction requirements, applicants must pay DCC an application fee. To meet other requirements, such as compliance with the California Environmental Quality Act (CEQA), applicants for a provisional license need only provide evidence that their efforts to meet DCC's requirements is underway. Thus, the provisional licensing process expedited the ability of applicants to operate legally in California as cannabis businesses.

However, most provisional licenses will no longer be effective after January 1, 2026. To continue operating legally under California law after this date, applicants must obtain an annual state license, which requires them to, among other things, finish completing any requirements for annual licensure that were underway at the time they obtained their provisional license. Until applicants obtain an annual state license, they may not be in full compliance with all requirements, including requirements related to environmental protection, as described further.

3 The nonmedical personal use of marijuana (cannabis) is still illegal under federal law.

4 For a commercial cannabis business to operate legally in California, it must obtain approval from DCC and satisfy any requirements for operation imposed by the local jurisdiction (typically a city or county) in which it intends to operate. Although local jurisdictions sometimes use different terminology, to avoid confusion in this report, we distinguish between local and state approvals by referring to local approval of *permits* and state approval of *licenses*.

Three state entities each oversaw particular types of cannabis business licensure until the Department of Cannabis Control (DCC) was established in July 2021, as the text box details. These entities' responsibilities were consolidated under DCC, which now issues annual state licenses for all cannabis businesses, including cultivation, retail, and manufacturing businesses. However, DCC stopped issuing most provisional licenses as of October 2022. DCC may continue issuing provisional licenses to local equity applicants for retail business until January 1, 2031.

Three State Agencies Regulated Cannabis Businesses Following Legalization of Nonmedical Marijuana Under California Law Until DCC Assumed These Responsibilities in July 2021

California Department of Food and Agriculture
- Cannabis Cultivation

California Department of Public Health
- Cannabis Manufacturing

Bureau of Cannabis Control*
- Cannabis Retailers
- Cannabis Distributors
- Cannabis Microbusinesses
- Cannabis Testing Laboratories
- Cannabis Event Organizers

Source: State law and California State Association of Counties' *Local Government Reference Guide to Proposition 64*.

* Formerly known as the Bureau of Medical Cannabis Regulation and the Bureau of Medical Marijuana Regulation.

A local equity applicant is an individual applying for a commercial cannabis license who participates in a jurisdiction's local equity program. These programs focus on the inclusion and support of individuals and communities in the State's cannabis industry who are linked to populations or neighborhoods that have experienced negative or disproportionate impact from cannabis criminalization. According to DCC, cannabis business owners face many challenges to getting started, including difficulties gaining access to capital and obtaining technical support, which can be even harder for individuals who were affected by cannabis criminalization. Equity programs as described in state law may include such services as technical assistance for small businesses, fee waivers, and assistance in securing capital investments.

California Environmental Quality Act

State law allows an applicant to obtain a provisional license without completing certain requirements necessary for annual state licensure. One such requirement pertains to compliance with CEQA. The purposes of CEQA are, among other things, to inform governmental decision-makers and the public about potentially substantial environmental effects of proposed activities and to prevent significant, avoidable damage to the environment. CEQA is relevant to licensing because cannabis businesses may harm environmental quality. For example, cannabis cultivation can result in fertilizer runoff leaching into watersheds, with negative consequences for wildlife. All types of cannabis businesses, including retail and manufacturing businesses, must comply with CEQA or show that their business is exempt from the requirements. To obtain a provisional license, and then to renew a provisional license, an applicant must provide evidence to DCC that the business is in the process of complying with CEQA, if it has not yet done so. To then meet annual state licensing requirements, the applicant must complete the CEQA process and provide proof that the business is either exempt from or has complied with CEQA.

Establishing the Local Jurisdiction Assistance Grant Program

The Budget Act of 2021 appropriated $100 million to DCC for the Local Jurisdiction Assistance Grant Program (Grant Program). The Grant Program was created in July 2021—the same month that DCC was established as an agency—to assist 17 selected local government jurisdictions of cities and counties (grantees) in helping commercial cannabis license holders who need the greatest assistance to transition from a provisional license to an annual state license. Figure 1 identifies these grantees and the maximum amounts the Legislature designated for each. According to the Budget Act, these 17 grantees had in their jurisdictions significant numbers of provisional licensees as well as provisional license holders with greater CEQA compliance requirements. The Budget Act established certain allowable uses for the grant funds, such as the preparation of environmental documents to achieve CEQA compliance, and other uses that further the intent of the Grant Program, which is to assist provisional license holders' transition to annual state licenses issued by DCC.

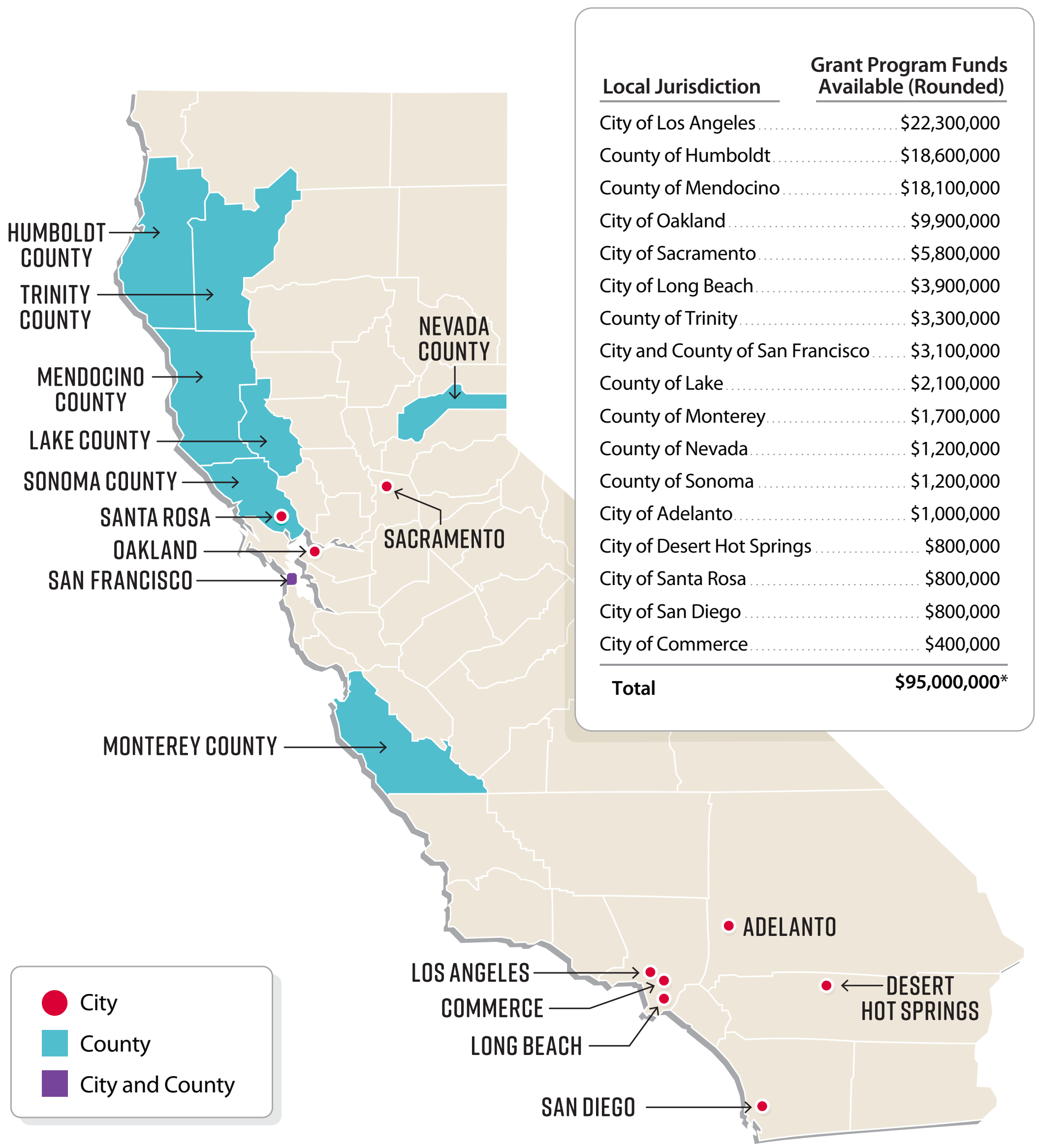
The Budget Act also designated $5 million of the $100 million for DCC to administer the Grant Program, and it established a deadline of June 30, 2025, for the grantees to expend or encumber the grant funds. All funds disbursed to the grantees that are not spent by that deadline will revert to the State's General Fund. Finally, the Budget Act required the California State Auditor, beginning in 2023, to conduct three annual performance audits of the grantees receiving funds from the Grant Program.

The work we conducted for this audit report generally pertains to the first year of the Grant Program, from January 2022 through December 2022. In addition to reviewing grant-related expenditures at all 17 grantees, we selected six of these grantees for further review: the counties of Humboldt, Lake, and Trinity, and the cities of Commerce, Los Angeles, and Santa Rosa. We based this selection in part on the amount of grant funds these grantees reported spending and the percentage of provisional license holders in their jurisdictions to whom DCC stated it had issued annual state licenses.

As part of its process for awarding the grant funds, DCC required each of the grantees to submit an application containing an annual plan that described how the jurisdiction intended to use those funds to help provisional license holders' transition to annual state licenses. In its grant guidelines and application instructions, DCC stated that its application review would include assessing the jurisdiction's proposed budget and the jurisdiction's objectives and goals for helping provisional license holders obtain annual state licenses. The annual plan that a jurisdiction submitted as part of its grant application then became part of the scope of work for the grant agreement.

By January 2022, DCC had approved agreements with all of the grantees, and it began disbursing grant funds in February 2022. DCC had disbursed 80 percent of the amount awarded to each grantee by the end of April 2022. It withheld the remaining 20 percent until grantees had substantially met the goals and intended outcomes of their annual plans. As part of the initial agreements, DCC also required grantees to provide biannual progress reports. DCC's grant guidelines stated that in these reports, grantees must be able to demonstrate that grant funds were spent for eligible uses and were consistent with the activities detailed in their applications. DCC required grantees to submit the first biannual report in August 2022 and the second in February 2023.

Figure 1
Seventeen Local Jurisdictions Were Eligible to Receive Grant Funding



Local Jurisdiction	Grant Program Funds Available (Rounded)
City of Los Angeles	$22,300,000
County of Humboldt	$18,600,000
County of Mendocino	$18,100,000
City of Oakland	$9,900,000
City of Sacramento	$5,800,000
City of Long Beach	$3,900,000
County of Trinity	$3,300,000
City and County of San Francisco	$3,100,000
County of Lake	$2,100,000
County of Monterey	$1,700,000
County of Nevada	$1,200,000
County of Sonoma	$1,200,000
City of Adelanto	$1,000,000
City of Desert Hot Springs	$800,000
City of Santa Rosa	$800,000
City of San Diego	$800,000
City of Commerce	$400,000
Total	**$95,000,000***

Source: State law.

* The total does not include the $5 million appropriated to DCC for administering the Grant Program.

DCC's Office of Grants Management (OGM) administers the Grant Program. According to its operations branch chief, OGM generally had two staff members during the period we reviewed, a grants manager and a grants management analyst. OGM also administered other grants during this time, including the Local Jurisdiction Retail Access Grant, which provides funding to local governments to develop and implement cannabis retail licensing programs.

July 2023 Management Letter From the State Auditor to DCC

The Grant Program has a relatively short lifespan of four years. Because of the severity and pervasiveness of the issues we identified in DCC's management of the Grant Program, we sent a letter to DCC's director in July 2023 (management letter) describing our concerns in advance of our completion of this audit, so that DCC could begin taking corrective action. The text box lists the concerns we described in the letter. We discuss these issues and DCC's actions in response in more detail in Chapter 1. However, not all of DCC's actions have fully addressed our concerns, and we subsequently identified some additional concerns about other aspects of DCC's management of the Grant Program.

Concerns Described in Management Letter to DCC

1. Approval of questionable grantee spending plans.
2. Advances of grant funds to grantees not prepared to receive them.
3. Lack of scrutiny over grantee spending and progress.
4. Misspending of administrative funds.
5. Lack of staff with necessary expertise to oversee the Grant Program.

Source: July 2023 Management Letter to DCC.

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Chapter 1

DCC DID NOT APPROPRIATELY OVERSEE THE GRANT PROGRAM

- DCC has not effectively overseen the Grant Program or effectively used its administrative funds, causing delays in some grantees' spending of grant funds and creating risks that the Grant Program will not accomplish its primary purpose.
- DCC's oversight lapses include approving grantees' uses of the funds unrelated to the program's purpose; not following grant management best practices in multiple areas, including in the way DCC disbursed funds and monitored expenditures; and not approving some grant amendment requests in a timely manner.
- These lapses result from DCC not employing sufficient staff to manage the Grant Program, and the staff that it did hire or transfer to this program did not possess prior experience managing a grant program.

One Grant Agreement DCC Approved Included Plans That Did Not Align With the Grant Program's Purpose

The Grant Program's purpose is to support local jurisdictions in aiding provisional license holders meet those requirements that are necessary to attain an annual state license. However, DCC approved an $18 million grant agreement—the second largest grant in the entire program—for the county of Humboldt that allows the jurisdiction to use as much as $15 million of the funds for purposes unrelated to the Grant Program's intent. DCC's review of this grant agreement merited additional attention, considering that the county's grant was nearly 20 percent of the Grant Program's total grant funds.

The county of Humboldt proposed using up to $15 million to provide sub-grants to commercial cannabis license holders, including both provisional license holders and those that had already obtained annual state licenses. The county intended these sub-grants to help offset the costs license holders incurred in reducing their businesses' environmental impact. For example, the businesses could use the funds to transition from using gas-powered generators to using renewable energy sources. Although provisional licensees were the priority for these sub-grants, the county's director of planning and building acknowledged that the county's use of grant funds was never intended for the transition of provisional licenses to annual state licenses. He explained that most of Humboldt's cannabis businesses were making progress toward obtaining annual state licenses and that the county's goal for using these funds was to ensure environmental protection and to address roadblocks to obtaining local permits.

Although that goal may benefit the county of Humboldt and its residents, providing sub-grants to cannabis businesses that have already obtained an annual state license does not align with the purpose for which the Legislature appropriated these funds. In February 2023, the county Board of Supervisors passed a resolution that approved 259 applications for sub-grants that totaled more than $12 million. Documentation that the county presented to its Board of Supervisors showed that about 50 of those applications—totaling about $3 million—were from annual state license holders, and the remaining applications were from provisional license holders. As the oversight agency for the Grant Program, DCC was responsible for assessing the county's grant application and the purpose for which it intended to use the funds. When we raised this issue with DCC, its staff responded that DCC understood the county's sub-grants to commercial cannabis license holders were intended to aid license holders that held provisional permits to meet the county's conditions for approval. However, the county's grant agreement clearly states that some applicants for these sub-grants already held an annual state license, and the Grant Program funds were to support local jurisdictions in aiding provisional license holders with meeting the requirements to attain an annual state license.

DCC's Management of the Grant Program Has Not Aligned With Best Practices

Several different entities, including the Federal Office of Management and Budget and the Government Finance Officers Association (GFOA)—an organization whose mission is to advance excellence in public finance—have established guidance that DCC could have used to inform its implementation and oversight of the Grant Program. As Table 1 illustrates, DCC did not follow certain grant management best practices, such as limiting advance payments to the minimum amounts grantees needed and timing those payments to the grantees' actual, immediate cash requirements.

By not following established guidance and best practices, DCC has limited its ability to effectively administer the Grant Program and measure grantees' progress in assisting provisional license holders with obtaining annual state licenses. After we brought the issues in Table 1 to DCC's attention in July 2023, DCC stated that it intended to address many of them. For example, DCC developed an assessment questionnaire to use for future grant programs to determine applicants' readiness to manage grant funds. DCC said that if applicants score poorly on the assessment, it would institute additional safeguards in the grant agreement or require applicants to correct deficiencies. In addition, DCC's director provided context on why DCC chose to disburse 80 percent of the funds up front, stating DCC's belief that the Legislature intended it to promptly distribute the grant funds to allow local jurisdictions to meet the deadlines in state law. We acknowledge that the Legislature did use this language in a trailer bill to the Budget Act of 2021. DCC's chief deputy director added that grantees planned to use the funds for activities that would require lots of lead time, such as hiring staff or contractors, and thus DCC decided that the jurisdictions would need the funds quickly. Although we appreciate that DCC may have acted with the best interest of the grantees in mind, immediately advancing them nearly all of the grant funds increased the risk that the grantees would use the funds inappropriately, which we discuss in Chapter 2.

DCC did not initially issue guidance to the grantees on how to apply for the remaining 20 percent of the grant funds. The grant guidelines from October 2021 state that DCC would distribute the remaining 20 percent of the grant funds awarded to grantees, an amount totaling approximately $19 million, after grantees had *substantially* met the goals and intended outcomes in their annual plans. However, DCC did not define this term in the guidelines, leaving the grantees without a metric for demonstrating that they have met the benchmark and leaving DCC without a metric for evaluating whether grantees have met the benchmark.

Table 1
DCC Did Not Follow Certain Grant Management Best Practices

BEST PRACTICE	IMPLEMENTED BY DCC?	WHAT DCC COULD HAVE DONE	WHAT DCC DID	EFFECT
Announce funding opportunities publicly and describe application requirements.	✓	Posted information about the availability of funds and provided guidelines and instructions for applying for them.		Grantees were alerted to their eligibility to apply for the grant funds and how to do so.
Provide recipients with clear performance goals, indicators, targets, and baseline data.	✗	Provide specific criteria that it could use to determine whether the grantee has made measurable progress, such as by creating target dates for certain percentages of provisional licenses to be transitioned or by requiring grantees to provide metrics for each of the goals they established, such as timelines for completing environmental compliance-related reviews.	Did not require grantees to establish timelines for the action items associated with their goals.	Of the 51 grantee-established goals, there were only 13 instances in which grantees identified a timeline for completing one or more of the associated action items.* Consequently, DCC cannot determine whether grantees' progress is appropriate or aligns with their plans. Such determinations will be necessary for DCC's decisions about when and how to allocate remaining funds, whether grantees should revise their use of funds, or whether DCC needs to recapture any funds from the grantees.
			Did not initially define the criteria it would use to determine whether grantees would receive the remaining 20 percent of the funds.	Without clear performance metrics, it may have been challenging for grantees to effectively plan for their use of funds or take corrective actions.
Evaluate applicants' financial stability, management systems, and standards.	✗	Review recent audited financial statements and internal control reports for relevant findings and provide technical assistance and site visits for those identified to be at higher risk of financial mismanagement.	Did not perform risk assessments or determine whether grantees had sufficient internal controls in place to properly account for the grant funds.	Two grantees received adverse opinions on portions of their recent financial statements, and there were material weaknesses identified in their internal control reports. An *adverse opinion* indicates that an entity's financial statements do not fairly present its financial position, and *material weaknesses* in internal controls may indicate an increased risk of noncompliance with grant terms.
Limit advance payments to the minimum amounts needed and time those payments to the actual, immediate cash requirements.	✗	Disburse funds on a reimbursement basis or determine the amounts recipients need immediately and limit disbursements to those amounts.	Disbursed 80 percent of funds immediately without verifying recipients' immediate need for funds or the minimum amounts needed.	Most grantees reported that they spent little to no funds in the program's first year, and several are not earning interest on the unspent funds in their accounts. In addition, one grantee conveyed that the grants it received in the past were paid on a reimbursement basis, and the way that Grant Program funds were distributed caused problems because its systems and processes were not set up to process grants in this way.
Maintain a process to ensure that costs charged to grants are allowable, necessary, and reasonable.	✗	Request accounting records to verify the expenditures reported by grantees in their biannual reports and confirm selected expenditures by reviewing invoices, staff timekeeping reports, and other documentation.	Did not request any supporting documentation for the expenditures reported by grantees and relied solely on the information in the biannual reports, some of which was inconsistent and inaccurate.	DCC did not identify problems with grantees' expenditures that our review identified, including two grantees that were not tracking staff time dedicated to the Grant Program, one grantee that spent funds on items unrelated to the Grant Program, and one grantee that may have used the grant funds to supplant other funds.

Source: State law; the Code of Federal Regulations, Title 2, Part 200*;* GFOA's best practices for grants administration; grant agreements; interviews with DCC staff; the Public Company Accounting Oversight Board's auditing standards; and auditor analysis.

* Four grantees did not complete the "Goals" section of their grant applications and only completed the "Action Items" section. We considered those grantees to have established only one goal, but we did not consider these action items to be individual goals.

DCC's former grants manager explained that DCC would begin considering the issue after the August 2023 biannual reports were submitted.[5] In November 2023, the operations branch chief explained that DCC was preparing instructions for grantees on how to submit a request for the remaining funds. DCC sent those instructions to grantees in April 2024.

DCC has not yet addressed all of the issues we identified. Specifically, DCC still needs to improve its monitoring of grantees' expenditures. DCC's decision to advance 80 percent of the grant funds to grantees increased the importance of its monitoring of that spending. However, the former grants manager stated that because of insufficient staffing, she did not verify grantees' reported expenditures, nor did she request additional documentation to ensure that grantees spent the funds as they reported in their biannual reports. Instead, she used the grantees' biannual reports to assess whether they were spending funds appropriately. However, she did not articulate the criteria or measures she used to do so.

DCC's chief deputy director said DCC intended to leverage our office's statutorily required audit to support its oversight. She also stated that the OGM requested documentation to investigate certain expenditures. Nevertheless, DCC is responsible for administering the Grant Program, and state law establishes our role as auditing the performance of the program—not performing administrative functions, such as overseeing the grantees and their expenditures.

Because DCC has not conducted sufficient monitoring, including verifying that grantees have used grant funds for the purpose the Legislature appropriated those funds, DCC had not identified problems with grantee spending that our audit identified. For example, we determined that the city of San Diego inappropriately spent $6,000 during 2022 to develop its equity program. The use of these funds that the deputy director of San Diego's Cannabis Business Division described, which involved establishing and promoting a new local equity program in the city, did not align with the requirement in state law that funds could be used for an existing equity program. When we described this issue to DCC's chief deputy director, she agreed that a grantee could not use the grant funds to develop an equity program. However, DCC did not identify these expenditures as potentially inappropriate even after San Diego reported them in its February 2023 biannual report.

During the course of our audit work, several of the grantees stated that their use of the funds did not focus solely on assisting provisional license holders. In some cases, grantees were instead using the funds for conducting work related to new applicants. For example, the city of Santa Rosa's senior planner explained that when a new local commercial cannabis business submits an application, she charges her time to the Grant Program for assisting these new applicants. The city of Sacramento, which used about $100,000 during 2022 on sub-grants to commercial cannabis businesses for making security system improvements, stated that it did not confirm whether applicants had a valid state license. This means that some of Sacramento's grant recipients may have already held an annual state license, and others may have been new applicants who did not hold a provisional license. In either scenario, the grant funds would not have been used to help a provisional license holder obtain an annual state license. Moreover, staff at the city of San Diego

[5] The grants manager at the time of our audit fieldwork left DCC in October 2023. Thus, we refer to her as the *former grants manager* throughout this report.

stated that the city does not believe it has any involvement in the process of transitioning provisional licenses to annual state licenses because that process is a DCC responsibility. However, assisting provisional license holders with obtaining an annual state license is the very purpose for which the grantees were awarded these funds.

DCC's chief deputy director explained that grantees can use the funds for new retail equity applicants but that using the funds on any other type of new applicants is unallowable. She also stated that DCC would clarify the allowable uses of the funds in new guidance to the grantees. Although we did not review supporting documentation for all grant expenditures made by each grantee to date, the information that came to our attention suggests that DCC should be closely monitoring the grantees' expenditures to ensure that they are related to the purpose for which these funds were appropriated.

If DCC had issued the funds to grantees on a reimbursement basis, it would have been able to request supporting documentation and review the nature of the expenditures before it issued grant funds to grantees for those expenditures. It is unclear why grantees would need the funds immediately if their planned activities required significant lead time, and the chief deputy director confirmed that DCC did not verify whether grantees actually needed the funds so quickly. In fact, many grantees have been slow to spend their funds. As Table 2 shows, the majority of the grantees made minimal expenditures in the first year of the Grant Program, spending only $2 million of the $95 million that DCC awarded, or only 2 percent. In part, some of the delayed spending occurred because DCC was not processing grant amendment requests in a timely manner, as we describe in the next section. However, had DCC retained the funds and paid grantees only when they were able to demonstrate that they had incurred allowed costs, it would have safeguarded against disallowed expenditures.

Some Grantees' Spending Was Delayed by DCC's Protracted Responses to Their Amendment Requests

Best practices for federal grant requirements suggest that if a grantee requests an amendment to the grant agreement and the awarding agency takes more than 30 calendar days to consider the request, the awarding agency should inform the grantee in writing of the expected decision date. The agreements that DCC made with the grantees specified a more stringent goal: if a grantee requests a change to the scope of work, budget, or project term, DCC would respond in writing within 10 business days to inform the grantee of whether the proposed changes are accepted. In at least five instances, however, DCC did not adhere to this time frame nor communicate expected decision dates as best practices suggest. Consequently, some grantees did not spend their funds because they were waiting for DCC to determine whether their new proposed use of the funds was allowable. As of April 2023, seven grantees had submitted amendment requests, and DCC had not processed the majority of these amendments promptly, with three grantees each waiting more than 100 days for a decision, as Figure 2 shows.[6] These amendment requests include reallocating funds for additional staff, budget modifications, and new consulting contracts.

6 Additional amendment requests from other grantees were submitted to DCC after we performed our audit work.

Table 2
Many Grantees Did Not Spend Significant Amounts of Their Grant Funds in 2022

GRANTEE	2022 ACTIVITY			
	AMOUNT AWARDED BY DCC*	AMOUNT SPENT*	PERCENTAGE SPENT	GRANTEE SUBMITTED AN AMENDMENT REQUEST AS OF APRIL 2023
City of Adelanto	$973,000	$6,000	1%	YES
City of Commerce	416,000	Unable to determine because Commerce did not attribute expenditures to the grant in its accounting system.	Unknown	NO
City of Desert Hot Springs	822,000	No funds spent because the city council had not approved a contract with a consultant to administer the program as of December 2022.	0	NO
County of Humboldt	18,635,000	Unable to determine because Humboldt's financial system did not contain all of its grant expenditures.	Unknown	YES
County of Lake	2,101,000	461,000	22	NO
City of Long Beach	3,935,000	20,000†	1	NO
City of Los Angeles	22,312,000	Did not charge its grant funds for any costs but tracked approximately $272,000 in personnel expenses that it intended to charge to the grant at a later date.	0	NO
County of Mendocino	17,586,000	330,000	2	NO
County of Monterey	1,737,000	66,000	4	YES
County of Nevada	1,221,000	1,000	Less than 1	YES
City of Oakland	9,905,000	197,000	2	NO
City of Sacramento	5,787,000	171,000	3	NO
City of San Diego	764,000	6,000	1	YES
City and County of San Francisco	3,076,000	196,000	6	NO
City of Santa Rosa	776,000	49,000	6	NO
County of Sonoma	1,158,000	198,000	17	YES
County of Trinity	3,294,000	314,000†	10	YES
Totals	**$94,498,000**	**$2,015,000**	**2%**	

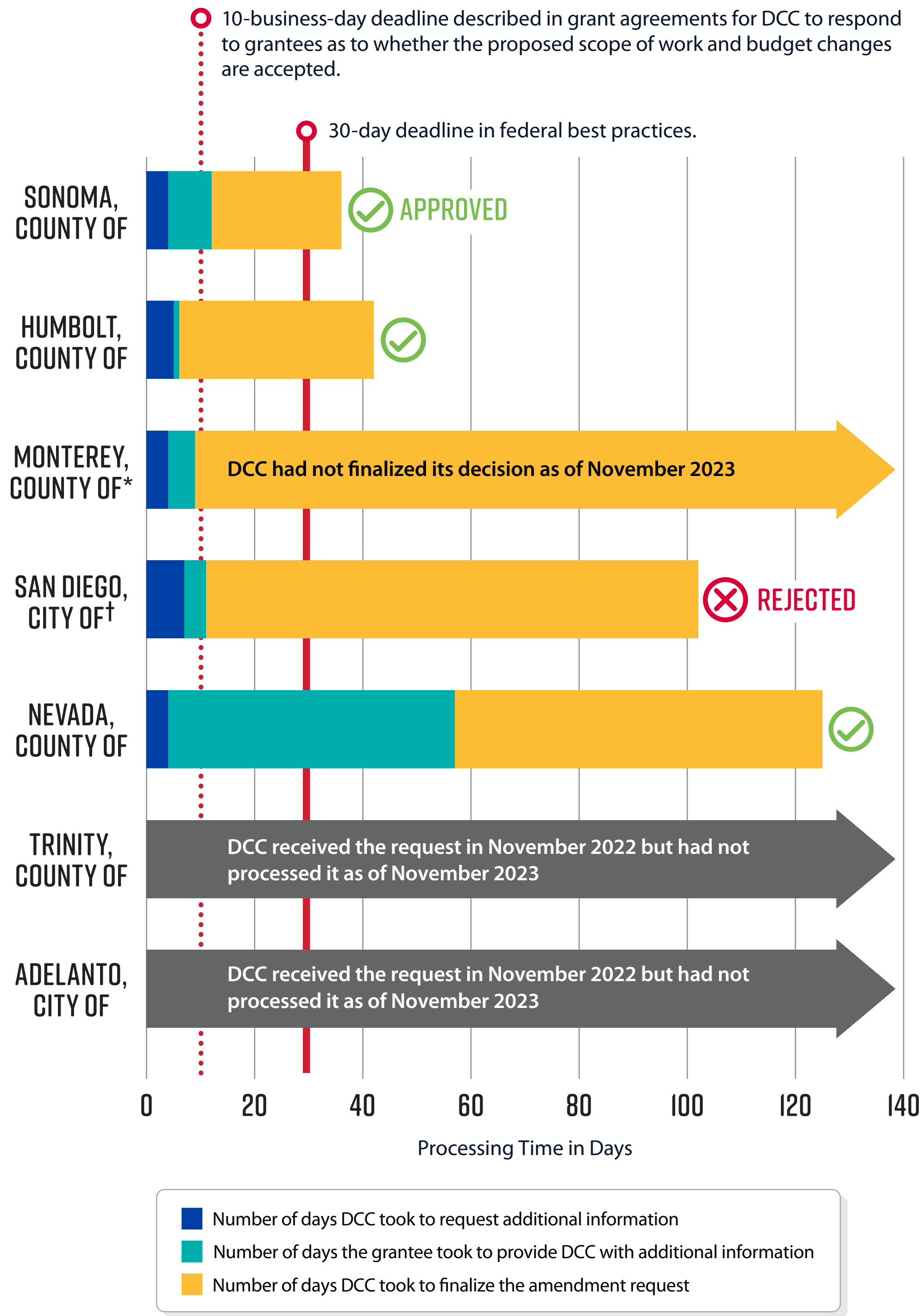
Source: DCC grant agreements, interviews with DCC staff, grantee amendment requests, and expenditure data from grantees' financial systems.

* Dollar amounts are rounded to the nearest thousand.

† As Table 3 describes, this grantee underreported its expenditures.

Figure 2

DCC's Slow Review of Grant Amendments Has Inhibited Some Grantees' Ability to Adjust Spending Plans



Source: DCC grant agreements, amendment requests, and email communication.

Note: This figure presents the status of these seven amendment requests as of November 2023, which was the end of our fieldwork.

* In January 2023, DCC sent Monterey an email stating that the amendment request was approved, but DCC indicated to us that it sent the email in error and the request was still under review. As of November 2023, DCC had not yet informed Monterey that the email had been sent in error.

† DCC rejected San Diego's amendment request after determining that the proposed changes to its expenditures would not go toward transitioning provisional license holders to annual state licenses.

Several circumstances, including insufficient staffing—which we discuss in the next section—have contributed to DCC's lengthy amendment processing times. In some instances, grantees took weeks or months to provide requested information to DCC. For example, the county of Nevada took 53 business days to provide the information that DCC requested. However, DCC subsequently took another 68 days to review that information.

DCC's former grants manager attributed such delays to various factors, such as staff turnover, grantees' struggles to properly address grant agreements, an inefficient process for gathering requested information, a lack of DCC and grantee staff, and her need to prioritize other tasks. She also stated that the exhibit that set forth the 10-business-day deadline had been included in the agreements in error and would be removed in subsequent amendments to the agreements, and she contended that having deadlines for amendment determinations was not feasible because of insufficient staffing.

The long amendment processing times have had negative consequences for some grantees. For example, although DCC ultimately approved the county of Nevada's amendment request, it took DCC more than three months to do so after it received additional information from the county, and a senior technician in the county's Cannabis and Code Compliance Divisions stated that the delay prevented the county from progressing toward its Grant Program goals.

Similarly, the county of Trinity, which submitted an amendment request in late November 2022, had not received a decision from DCC a year later, as of November 2023. The director of the county's Cannabis Division stated that the uncertainty around its amendment was limiting the county's ability to pursue opportunities for using its remaining grant funds, such as for acquiring new software to streamline its permitting processes.

After we discussed the amendment process with DCC in May 2023, DCC created a flowchart of the process it established for reviewing amendment requests. However, the documentation DCC provided does not establish any time frames for the steps in the process or for the total review process. Considering the short lifetime of the Grant Program, it is imperative that DCC establish, communicate, and uphold reasonable time frames for processing amendment requests.

To Improve Its Management of the Grant Program, DCC Could Have More Effectively Used the Administrative Funds It Was Appropriated for the Program

The Budget Act of 2021 authorized DCC to use up to 5 percent of the total amount appropriated for the Grant Program, or up to $5 million, for administrating the program during the approximately four years of the grant's lifespan. Although the Budget Act took effect in July 2021, DCC's deputy director of administration explained that DCC did not establish its OGM until January 2022. More than a year later, OGM was staffed in May 2023 with only a single grants manager to handle all 17 jurisdictions. It had previously also employed a grant management analyst. Both the grants manager and the grant management analyst were also responsible for managing at least one other grant program. Thus, just two people were tasked with administering the $100 million Grant Program, and on a part-time basis.

Notwithstanding the $5 million it was appropriated to administer the Grant Program, DCC's limited number of grant management staff resulted in insufficient oversight of the grantees. As of February 2023, DCC had used only $350,000 of the $5 million appropriated to it for program administration, or about 7 percent. DCC was on track to spend only 25 percent of the $5 million in administrative funds in the remaining two-and-a-half years before the Grant Program ends. However, the consequences of understaffing were evident in the oversight tasks DCC had not performed, such as assessing whether costs were allowable and processing grant agreement amendment requests in a timely manner. When we discussed these neglected oversight tasks with DCC's former grants manager, she stated that she did not have the time or resources to implement best practices or perform expected administrative tasks. Thus, there was an evident need for additional staff to provide oversight of the Grant Program.

Even though DCC experienced an increasing backlog of tasks that were not being completed, it had not developed a plan for how it would use the administrative funds it was appropriated to administer the grant. As of July 2023, despite our repeated requests, DCC had not provided a budget for how it initially planned to use the $5 million appropriated to it to administer the grant. Our interviews with DCC management suggest that there was a lack of effective internal communication about the insufficient resources and no plan in place to evaluate staffing needs. The chief deputy director told us in May 2023 that she was not aware of any problems with administering or overseeing the grant or grantees because of insufficient staff.

In contrast, the deputy director of administration stated around the same time in May 2023 that she had requested staff to perform a workload analysis to determine the appropriate number of staff for the OGM now that its duties were better known. However, at that time, DCC was not tracking the amount of time that any of the staff paid with grant funds spent on the Grant Program. It did not begin to do so until July 2023, after we had shared our concerns.

Further illustrating DCC's inadequate communication involving staffing, the operations branch chief explained in May 2023 that she had held informal conversations with her supervisors about the lack of staff but had not formally presented her concerns to executive management because she first wanted to collect information demonstrating the amount of time and work the Grant Program required. By then, additional problems had emerged, including delays in processing amendment requests, and DCC not defining the term *substantial* progress so that grantees would know what they needed to accomplish to receive the remaining 20 percent of funds. The operations branch chief stated at the end of May 2023 that she had begun using staff from other areas to assist with the administration of the Grant Program.

After DCC received our July 2023 management letter outlining our concerns about insufficient staffing, it hired additional staff. By February 2024, the OGM included four staff with Grant Program responsibilities: a grants manager, two grants management analysts, and a retired annuitant. In November 2023, the deputy director of administration provided us with a spending plan for $3.3 million of the administrative funds.

Some of the administrative funds DCC did spend were used for unallowable costs: those funds paid the salaries of staff whose tasks sometimes involved work not related to managing the Grant Program and sometimes involved completely different grants. The $350,000 that DCC had used as of February 2023 was spent on the salaries of the grants manager, a grants management analyst, and four environmental scientist positions. However, the four environmental scientists were tasked with processing license applications, which was not an activity directly related to managing the Grant Program. According to a DCC supervisor who manages two of the environmental scientists, his team does not work on assisting provisional license holders with obtaining an annual state license. In addition, although the grants manager and grant management analyst worked on multiple grant programs, their entire salaries were paid for by this Grant Program.

When we informed DCC in July 2023 of our concerns about these expenditures, it took steps to address them. The chief deputy director agreed that the routine processing of license applications—the work the environmental scientists were completing—was not an activity that should be charged to the administration of the grant. She stated that she assumed the environmental scientist staff were dedicated to Grant Program activities. To address this issue, DCC identified those staff that it allowed to charge time to the Grant Program and in October 2023 made corrections to move the related expenditures from the Grant Program to another fund. Further, in July 2023, DCC began tracking the time staff reported spending on activities related to the Grant Program.

The results of the first month of tracking time in this way show that the staff in the licensing division who worked on the program spent between 0 percent and 8 percent of their time on grant-related activities and that the former grants manager spent about 64 percent of her time on the program. The deputy director of administration stated in November 2023 that DCC estimated the amounts that were incorrectly spent in the past and that its accounting staff had completed the expenditure corrections to reimburse the Cannabis Control fund for the misspent administrative funds.

DCC's Grant Management Staff Did Not Have Sufficient Expertise to Manage a Program of This Complexity

State law authorizes DCC to undertake certain duties in administering the Grant Program, including—but not limited to—promulgating grant rules and recapturing disbursed funds if grantees fail to demonstrate progress. However, DCC staff did not have the expertise necessary to manage a program of this size. As a result, DCC staff have made a number of decisions that do not align with best practices, which we discuss previously.

DCC staff themselves attributed some grant management mistakes to their own lack of experience. For example, the former grants manager attributed the erroneous inclusion of exhibits in the grant agreements—such as the 10-business-day deadline we discuss earlier—to her lack of experience preparing these type of documents. Therefore, we would have expected DCC to conduct a thorough review to ensure that the agreements were appropriate. However, the operations branch chief, the person who signed the grant agreements for DCC, stated that she did not review the agreements and that the deputy director for administration had reviewed them instead. She believed that dividing the review and signature of the agreements was intended to maintain a separation of duties that she claimed was required by the *State Administrative Manual*. However, we were unable to identify any such requirement or rationale for such a requirement. The deputy director for administration who reviewed the agreements was unable to explain why her review did not identify the erroneous exhibits, and she attributed their inclusion in the grant agreements to human error.

DCC staff also did not clearly delineate certain responsibilities regarding program oversight, creating gaps in processes and accountability. For example, the former grants manager stated that the grantees' progress is reviewed by DCC's licensing division. However, a supervisor in the licensing division explained that her division does not set benchmarks or metrics to track a grantee's progress. Thus, it was not clear who was responsible for determining whether the Grant Program was on track to accomplish its purpose. Although the licensing division supervisor provided a spreadsheet showing the number of provisional licenses that were still active in each month, DCC did not establish any expectations for grantees' progress or determine at what rate licenses needed to be transitioned to ensure that the Grant Program would achieve its primary goal of helping provisional license holders obtain annual state licenses.

Similarly, the information DCC asked grantees to provide in their biannual reports was not always necessary or useful. For example, the template DCC provided to the grantees for the initial biannual report due in August 2022 did not direct the grantees to report their actual expenditures. Instead, it directed grantees to provide their budgeted expenditures, information they had already provided in their original grant application. Thus, DCC was not able to determine how much the grantees had spent during the first six months of the program. DCC modified the biannual report template for the February 2023 reports to request grantees to report actual expenditures. However, as we discuss earlier, grantees collectively spent only 2 percent of the funding that DCC awarded.

DCC also required grantees in the February 2023 and August 2023 reports to provide the numbers and status of provisional and annual state licenses issued to applicants in their jurisdictions. However, because DCC already maintains these licensing data, it is unclear why DCC would ask grantees to report the same licensing data. In response to our questions, DCC eliminated the requirement to submit state license data for the February 2024 biannual report.

DCC also did not provide grantees with guidance on how to manage the grant funds they received. In particular, DCC did not specify whether grantees should put the funds in interest-bearing accounts or what they were to do with accumulated interest. State law directs all money belonging to or in the custody of a local agency to be deposited with certain types of financial entities or to be invested in specified investments authorized by law. Case law also establishes that interest generally must be used for the same purpose as the principal from which it was earned, meaning that grantees must use this interest for the Grant Program. Grant agreements commonly define whether funds are to be kept in an interest‑bearing account and how the interest is to be used. However, DCC's grant agreements with the 17 grantees did not include these provisions. As we note in Table 2, many grantees have received but not spent significant amounts, so interest earned on these funds should be used for the grant's intended purpose.

The former grants manager stated that DCC did not provide guidance on how to manage any interest earnings because it did not occur to staff that the interest from the funds would be an issue or that it was DCC's responsibility to provide such guidance, highlighting a lack of experience in managing a grant program. Moreover, we found that 10 grantees were not dedicating interest earned on the funds to the purpose of the Grant Program. For instance, the city and county of San Francisco did not dedicate to the Grant Program the $20,000 in interest that it earned as of December 2022 on its $3.1 million in Grant Program funds. In contrast, the city of San Diego had earned more than $4,800 in interest as of March 2023 on the $611,000 in Grant Program funds that DCC advanced the city—interest that San Diego credited to the grant.

Because DCC chose to advance 80 percent of the funds instead of issuing them on a reimbursement basis, communicating with grantees about how to deal with interest should have been a priority for this Grant Program as it is for federal grant programs. In November 2023, DCC developed guidance related to interest earned on grant funds, although the guidance did not explicitly recommend that the grantees place the funds in interest‑bearing accounts or clarify that the accrued interest on those funds must be used for the purpose of the Grant Program. In addition, DCC stated in March 2024 that it only provides the guidance to grantees upon request, and only the city and county of San Francisco had requested the information.

The chief deputy director explained that at the time the Grant Program was established, no one at DCC had much experience with grant management. In particular, she said that no one anticipated the complexity and workload that would be involved in administering the program. The former grants manager explained that her experience with grant programs was confined to the application process and that she had not previously performed any post‑award administrative work. She also explained that she had cross‑trained with the California Department of Food and Agriculture's grants program when she became the grants manager at DCC, but that those grants differed greatly from the Grant Program. Moreover, the operations branch chief and deputy director of administration stated that although they had some experience with federal grants, they had not found their past experience particularly applicable to the Grant Program.

After we raised in our July 2023 management letter our concerns about staff's inexperience, DCC indicated in October 2023 that it was enrolling its OGM staff in several training classes, including a class on federal grants. As of March 2024, the OGM staff had taken these grant‑related training classes, and DCC had a contract in place to provide staff with recurring annual training on grant management practices. These are useful steps that may result in stronger grant management practices at DCC in the long run. However, time is short since the Grant Program's funds revert to the State's General Fund if not expended or encumbered by June 30, 2025.

Recommendations

DCC

To better align its management of grant programs with best practices, by February 2025, DCC should institute a grants management policy. This policy should accomplish the following actions at a minimum:

- Designate the DCC staff member responsible for determining that proposed activities and costs are allowable during the grant review process.
- Establish a process to ensure that each element of the policy has been reviewed, such as reviewing costs for allowability.
- Establish benchmarks or other criteria in grant agreements for measuring grantee progress toward a grant program's goals.
- Specify the preferred method for disbursing grant funds, taking into account common grant management best practices.
- Establish an amendment review process that includes internal and external deadlines to ensure DCC processes amendments in a timelier manner.
- Establish procedures for monitoring expenditures and determining their allowability.
- Establish a method to track the time that DCC staff spend working on grant-related activities.

To provide grantees with timely feedback about whether their spending is allowable or whether they will be required to return funds, DCC should immediately begin reviewing grantees' expenditures to determine whether their expenditures are appropriate and begin communicating those determinations to the grantees.

To help ensure that state grant funds and related interest benefit only the Grant Program, DCC should immediately recommend that all grantees place any unspent grant funds in interest-bearing accounts. Further, DCC should direct grantees to track and report to DCC any interest accrued from those funds, and clarify that the accrued interest be used only for the purpose of the Grant Program.

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Chapter 2

SOME GRANTEES DID NOT MANAGE THEIR GRANT FUNDS PROPERLY

- We found that four of the 17 grantees did not adequately track their grant funds, two grantees did not track and document whether staff time was spent on tasks related to the grant, and two grantees charged expenditures to the Grant Program that were unrelated to its purpose.

- Noncompliance with the Grant Program's requirements risks DCC disallowing expenditures that the grantees intended to pay for with grant funds.

DCC's Ability to Accurately Track Spending Is Hindered by Four Grantees That Did Not Properly Account for All Grant-Related Financial Transactions

Many of the grantees tracked their expenditures, but four of 17 did not do so. As part of our review of grantees' expenditures, we obtained financial data from each grantee and determined whether the grantee's receipt of grant funds—as well as its expenditure of grant funds, if any—had been properly assigned to the Grant Program. The GFOA suggests that grantees establish a grant fund, or unique project identifier, to account for the relevant financial transactions. This guidance can help ensure that grantees properly attribute expenditures to the grant.

The agreements between DCC and the grantees also require grantees to maintain adequate documentation of transactions so that DCC can evaluate whether the expenditures are allowable. We found that four of the 17 grantees we reviewed did not adequately track their grant funds. Two grantees—the city of Commerce and the county of Trinity—did not establish a unique identifier for their grant funds, as Table 3 shows, and the city of Long Beach underreported its expenditures because it did not attribute them to the grant in its financial system in a timely manner.

Not properly tracking expenditures of grant funds can cause several problems. A grantee that does not properly track grant funds might commingle Grant Program funds with other grants and revenues, making it unclear to what program the funds or associated expenditures belong and risking that the grantee will spend the funds on unallowable activities. Further, when grantees do not accurately track expenditures, they limit their own ability to appropriately budget their remaining grant funds as well as limit DCC's ability to determine how much and how quickly they are spending the funds. Finally, grantees increase the risk that they will use their own funds to pay for grant-related expenditures if the grantees are not properly recording them as grant expenditures in their accounting systems. For example, as we describe in Table 3, the county of Humboldt used its general fund to pay for approximately $1,700 in grant-related expenditures because it did not accurately record expenditures in its financial system. After we brought these issues to the grantees' attention, they resolved some problems, as Table 3 shows. Nevertheless, we still make recommendations to three grantees to ensure that they appropriately track and record their grant expenditures.

Table 3
Some Grantees Did Not Properly Track Their Grant Expenses

INADEQUATE TRACKING OF EXPENDITURES

GRANTEE	ISSUE	REASON	OUTCOME	AUDITEE RESPONSE
City of Commerce	The city did not establish a unique project identifier or special fund to track grant expenditures in its financial system and used a spreadsheet instead.	The city stated that it does not have a policy on grants and had not established a method to track expenditures in its financial system because of turnover in the city's finance department.	The city was using a spreadsheet to track its expenditures manually, increasing the likelihood of errors and inaccurate reporting.	After we discussed our concerns with Commerce, the city created a unique project identifier in its financial system and retroactively associated its grant expenditures with this identifier.
County of Humboldt	There was a discrepancy of approximately $1,700 between the grant expenditures recorded in the county's financial system and the underlying documentation.	The county described several errors that contributed to this discrepancy, including charges not in its timekeeping system that were billed to the grant, charges in its timekeeping system that had not been charged to the grant, and charges applicable to a different grant that were incorrectly charged to this Grant Program.	Because it had not properly reconciled all of its expenditures to the grant before the end of its fiscal year, the county used its general fund to pay for the costs.	Humboldt stated that it plans to perform additional reviews of these types of expenditures in the future.
City of Long Beach	The city did not record certain grant expenditures in its financial system until two to three months after the expenditures occurred.	The city's method for processing its contractor's invoices resulted in an excessive delay in recognizing grant expenditures.	The city agreed that it underreported expenditures to DCC during its initial grant reporting period, which resulted in DCC not having an accurate status of the city's spending.	The city stated that it experienced significant staffing challenges, which caused a delay in the process of charging grant expenditures and recording expenditures to the Grant Program.
County of Trinity	The county did not initially establish a unique project identifier or special fund to track grant expenditures in its financial system, and it initially recorded them with other non-Grant Program-related expenditures. After establishing a unique identifier in November 2022, the county reassigned the expenditures to the grant, but it did not record them in the periods in which they occurred.	The county stated that significant turnover in cannabis program management and staff led to a lack of effective leadership and an absence of procedures for managing the grant funds.	The county's accounting system did not accurately summarize the expenditures it incurred during the first year of the grant. Therefore, the county did not report an accurate status of its spending to DCC.	Trinity asserted that it has a process in place that should have prevented these issues, but the process was not followed. The county cited management turnover and a lack of understanding the grant requirements. After we discussed this issue with Trinity, it established a unique identifier for the grant.

Source: Expenditure reports from grantees' financial management systems and interviews with grantee staff.

Some Grantees Could Not Justify Staff Costs Charged to the Grant Program

> **Federal Standards for Accounting for Staff Time Charged to a Grant**
>
> - Charges for salaries and wages must be based on records that accurately reflect the work performed.
> - Charges must be supported by a system of internal controls that provide reasonable assurance that those charges are accurate, allowable, and properly allocated.
> - Records must comply with the established accounting policies and practices of the entity.
> - Records must reasonably reflect the total activity for which employees are compensated by the entity.
> - Budget estimates alone do not qualify as support for charges to grant awards.
>
> Source: 2 Code of Federal Regulations part 200.430.

Federal regulations establish standards for the accounting of personnel costs paid with grants, as the text box describes, which we considered to be best practices. Further, DCC's Grant Program guidelines from October 2021 specify that salary and wage amounts charged to the grant must be based on an adequate payroll system. As part of our review, we evaluated a selection of expenditures for each grantee, such as staff costs and contractor invoices, for compliance with key grant agreement terms. Two grantees, whose actions we describe in Table 4, did not track and document the time employees spent working on grant-related projects. The city of Commerce simply estimated the hours that staff would spend on projects related to the Grant Program and then allocated a fixed percentage of their salaries to the grant. The county of Mendocino retroactively estimated the hours at some point after the work was performed. Neither grantee maintained contemporaneous information to support its determination of personnel costs. Thus, neither grantee could demonstrate that it had complied with the DCC requirement that employee compensation be based on an adequate payroll system and be supported with adequate documentation. When we informed DCC of these issues in late November 2023, its operations branch chief stated that DCC would need to review the expenditures itself before determining the appropriate course of action. Nevertheless, DCC began providing guidance to grantees in December 2023 about how to document staff time for grant-related projects.

Without documentation to support these expenditures, the two grantees were not able to provide us with adequate assurance that the charges to the Grant Program were allowable under the terms of their grant agreements. Thus, it is unclear whether these expenditures contributed to achieving the Grant Program's goals or whether DCC will require the funds to be returned.

Two Grantees Spent Grant Funds Inappropriately, Totaling $26,000 in Questioned Costs

Of the 17 grantees we reviewed, two grantees spent grant funds totaling $26,000 on purposes unrelated to the Grant Program or were unable to substantiate that their spending was for allowable costs. DCC's Grant Program guidelines require that all Grant Program expenditures must be for activities, products, and costs that have been included in an approved grant application proposal and budget. Additionally, state law specifically prohibits using the Grant Program funds to supplant existing cannabis-related funding. *Supplanting* occurs when a grantee reduces its existing spending for an activity because it is using grant funds or expects to use grant funds to fund that same activity. Supplanting may constitute a material breach of the grant agreement, is a violation of state law, and could result in DCC recapturing the grant funds. Federal best practices indicate that if a question of supplanting arises, it is the grantee's responsibility to substantiate that the reduction in local spending occurred for reasons other than the receipt or expected receipt of grant funds.

Table 4
Two Grantees Did Not Adequately Track $729,000 of Staff Costs Related to the Grant Program

	GRANTEE	ISSUE	REASON	OUTCOME	AUDITEE RESPONSE
NO TRACKING OF STAFF COSTS	City of Commerce	The city did not track the time city staff spent on grant-related tasks.	The city relied on an email from 2022 in which DCC stated that the way the city was reporting staff salaries on the grant was sufficient.	The city accounted for staff time by using estimates of time spent on the program that were predetermined according to the staff position. Thus, the city did not adequately account for the more than $51,000 in staff costs that it reported to DCC.	The city provided timesheets showing that in February 2024 it began to track the time staff spent on grant-related tasks.
	County of Mendocino	The county did not track and document the time employees spent working on grant-related projects. Instead, it directed its staff to estimate the hours spent on grant-related tasks several months after staff actually performed the work.	The county stated that its failure to establish an item in its time tracking system for tracking employee time spent on grant-related tasks was an oversight.	The county's method of estimating staff time spent on grant activities does not align with commonly accepted standards for tracking time spent by staff working on grant-related tasks. Thus, the county did not adequately account for more than $678,000 in staff time that it reported to DCC.	The county began tracking staff time spent on the Grant Program in March 2023.

Source: Expenditure reports from grantees' financial management systems, grantees' biannual progress report data, and interviews with grantee staff.

Through our review of a selection of expenditures among the grantees, we identified two grantees that had charged unallowable costs to the Grant Program. Table 5 describes these instances. Although the purposes for which one grantee used the funds were allowable, the grantee was unable to demonstrate that it did not use the funds to supplant its existing cannabis-related funding. In the other instance, the grantee used the funds for purposes other than helping provisional licensees obtain annual state licenses. Although neither of the grantees spent a significant portion of their total funds on these inappropriate expenditures, the occurrence of these expenditures indicates that the grantees were not adequately assessing whether the expenditures should be charged to the grant. If the rate at which the grantees spend grant funds increases in order to spend all of the funds by March 2025, their failure to determine whether spending is appropriate could lead to significant misspending. Such misspending could reduce the likelihood that the Grant Program will achieve its intended results.

Table 5
Two Grantees Could Not Substantiate That All of Their Grant Fund Spending Was Appropriate During the Grant Program's First Year

INAPPROPRIATE SPENDING

GRANTEE	ISSUE	REASON	OUTCOME	AUDITEE RESPONSE
City of Commerce	The city reported to DCC that about one-third, or nearly \$20,000, of the grant funds it used in 2022 were for existing employees and contract staff, but the city could not demonstrate that these individuals spent additional hours on grant-related tasks. For example, underlying documentation indicated that the city had not increased the hours for existing contract staff as it had committed to doing in its grant agreement. In fact, on average, the contractor's hours devoted to this purpose decreased in the six months after the city began using the grant funds to pay for a portion of these expenditures. Thus, the city could not substantiate that it had not used grant funds to supplant funding for preexisting activities.	The city did not have a method to track the actual time that city staff spent on grant-related tasks, so the city was unable to demonstrate that it had not simply used funds on existing staff without increasing the hours they spent on grant-related tasks.	The city's use of grant funds may have violated the supplanting prohibition in state law.	Commerce disagreed that it had supplanted existing cannabis funding with its grant funds. However, it did not explain its reasoning. Ultimately, it is DCC's responsibility to determine whether supplanting occurred and to recapture any misspent funds. DCC issued guidance to the grantees in October 2023 that it would perform a comprehensive analysis of grantees' budgets, expenditures, and supporting documentation to determine whether any funds are subject to recapture. Funds subject to recapture include funds used for ineligible purposes.
City of San Diego	The city used more than \$6,000 in grant funds to rent meeting space and provide translation services for the development of its equity program. However, developing an equity program is not an allowable use of these grant funds.	The city stated that it understood the language in its grant agreement with DCC to mean that it could use the grant funds to support future equity applicants and develop its equity program.	DCC stated that grant funds should not be used for these purposes. Thus, the city may have to return these grant funds based on the law and the October 2023 guidance issued by DCC.	San Diego stood by its perspective that DCC approved it to use funds in this way. There is some ambiguity in the grant agreement about whether San Diego intended to use the funds to establish a local equity program. Nevertheless, the purpose of this program is to help existing provisional license holders obtain annual state licenses.

Source: Expenditure reports from grantees' financial management systems, grantees' biannual progress reports and expenditure documentation, and interviews with DCC and grantee staff.

Recommendations

City of Commerce

To reduce the risk that DCC will require it to repay grant funds, the city of Commerce should immediately cease using grant funds in a manner that may supplant existing funding for its staff and contractors, review all expenditures it has paid for with grant funds, and reimburse Grant Program funds from its general fund for any unallowable or supplanted expenditures.

County of Humboldt

To ensure that it pays for all grant-related costs from the grant funds it has received, by February 2025, the county of Humboldt should accurately reconcile its grant expenditures before its fiscal year-end close.

City of Long Beach

To improve its ability to appropriately budget its grant funds and DCC's ability to determine how much of those funds the city is spending and how quickly it is spending them, by October 2024, the city of Long Beach should develop grant management procedures that establish a method for the accurate and timely accounting and reporting of grant-related expenditures.

City of San Diego

To reduce the risk that DCC will require it to repay grant funds, by October 2024, the city of San Diego should review all expenditures it has paid for with grant funds, clarify with DCC whether the expenditures are allowable, and reimburse the grant funds from its general fund for any unallowable expenditures.

Chapter 3

THE GRANT PROGRAM MAY NOT ACHIEVE ITS GOALS, AND DCC CANNOT DETERMINE THE CAUSES OF DELAYS IN LICENSE PROCESSING

- After the Grant Program's first year, a relatively small number of provisional license holders in the grantees' jurisdictions obtained an annual state license. The slow rate at which grantees spent their funds likely contributed to the lack of progress.

- On average, provisional licensees spent nearly two years to obtain annual state licenses in 2022. DCC did not consistently track a sufficient amount of data about the timeliness of its licensing process to thoroughly analyze the causes of lengthy processing times.

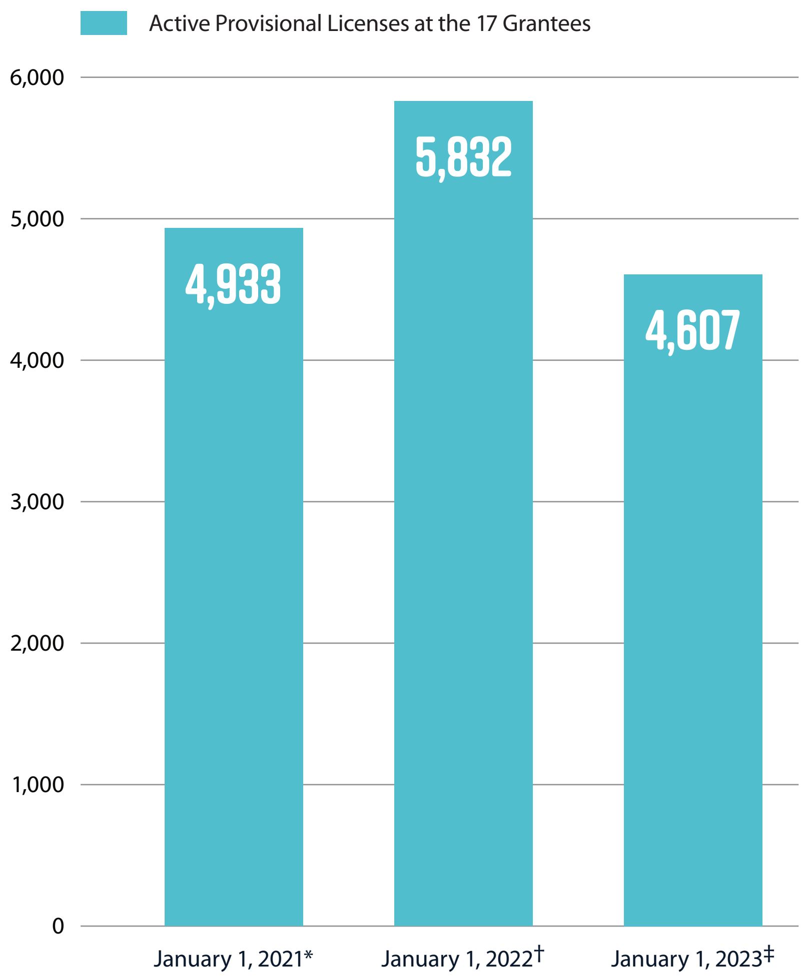
The Rate of Progress During the Program's First Year Raises Concerns About Whether the Grant Program Can Achieve Its Purpose

During the first year of the Grant Program's four-year lifespan, grantees made limited progress toward the program's primary purpose of assisting provisional license holders to obtain an annual state license. State law requires grantees to expend or encumber grant funds by June 30, 2025, and provisional licenses issued by DCC will no longer be effective after January 2026, with limited exceptions. However, grantees are not on track to transition all of their licenses before they expire. During 2022—the first year of the Grant Program—only 535 provisional license holders obtained an annual state license.

Figure 3 shows that more than 4,600 provisional licenses still needed to transition to annual state licenses as of January 1, 2023. State law enabled DCC to continue issuing provisional licenses during 2022, and DCC can continue issuing provisional licenses to qualified equity retail applicants until 2031. Newly issued provisional licenses thus increased the number of provisional license holders between 2021 and 2023 that must obtain an annual state license. If DCC continues to issue the same number of annual state licenses to provisional license holders that it did during 2022, more than half of the provisional license holders in the grantees' jurisdictions will still not have obtained an annual state license by 2026.

It is not clear whether the grantees resolved the problems that prevent provisional license holders from obtaining annual state licenses in a timely manner. DCC directed jurisdictions to identify in their grant applications the permitting process challenges that impeded provisional license holders' transition to annual state licenses, and DCC required those jurisdictions to specify their goals and intended outcomes. Each jurisdiction described goals or actions associated with its use of the funds, such as hiring staff or contractors to decrease applicants' wait time for CEQA environmental reviews. The jurisdictions' use of their grant funds varied. However, DCC did not ensure that the grant agreements contained measurable benchmarks or metrics. In fact, DCC approved four grantees' grant agreements even though they did not provide goals. It is therefore difficult to assess the grantees' progress toward addressing the challenges they had identified. The relatively small number of provisional licenses transitioned to annual state licenses in the first year of the four-year program is not promising, although as we discuss below, certain factors likely impeded progress during the Grant Program's first year.

Figure 3
A Significant Number of Provisional Licenses at the 17 Grantees Remained Active in January 2023



Source: Analysis of DCC's manufacturing, cultivation, and retail and distribution licensing systems.

* Because of limitations in the manufacturing licensing system, manufacturing licenses are excluded from the count of provisional licenses that were active as of January 1, 2021.

† The issuance of new provisional licenses contributed to the increase in provisional licenses between 2021 and 2022. Further, the inclusion of manufacturing licensing data, which are not present in the analysis for 2021, adds approximately 400 active provisional licenses to the count for 2022. Appendix A presents further details on the numbers of provisional and annual state licenses at all 17 grantees.

‡ Because of inconsistent information contained in the manufacturing licensing system and printed on the license certificates, we were unable to discern whether eight licenses that were active as of January 2022 or January 2023 were in provisional or annual status. We counted them as provisional for the purpose of this figure.

We found that on average, provisional license holders in the 17 Grant Program jurisdictions obtained annual state licenses during 2022 at approximately the same rate they had during the year before the jurisdictions received the grant funds. Grantees expended a limited amount of grant funds during that first year, which may have contributed to the relatively small number of provisional license holders that obtained annual state licenses. The grantees' overall slow pace in spending their grant funds is understandable in some cases because, for example, it can take time to recruit new staff or to execute contracts. Nevertheless, grantees' minimal grant fund expenditures during the program's first year likely resulted in the Grant Program's minimal initial impact.

We selected six of the 17 grantees for additional review, basing our selection in part on the rate at which provisional license holders in their jurisdictions had obtained annual state licenses. Table 6 identifies the six grantees, describes their use of the grant funds during 2022, and quantifies their progress toward helping provisional license holders transition to annual state licenses. As the table shows, grantees encountered some barriers to progress, such as a delay in hiring new staff, or in the case of one grantee, delayed city council action that held up until June 2023 changes to its application process that would facilitate provisional license holders transition to annual state licenses.

Moreover, the progress one grantee made does not appear to be attributable to its use of the grant funds. Even though provisional license holders in the county of Humboldt have obtained annual state licenses at a higher rate than those at many other grantees, as we discuss earlier, the county's grant agreement indicates that it plans to use a portion of its funds for purposes unrelated to the intent of the Grant Program. The county's director of planning and building stated that the county's progress could be credited to the county's development of regulations that, when complied with, meant that local cannabis businesses were prepared to meet the state requirements.

DCC Does Not Track the Timeliness of Its Licensing Process

The process for a provisional license holder to obtain an annual state license takes an average of nearly two years. Local permitting plays a significant role in the process of obtaining an annual state license, but it is ultimately DCC's responsibility to issue those licenses. We reviewed DCC's licensing data for each license type, and we determined the average processing times for annual state license applications in each grantee's jurisdiction. We found that on average, it took nearly two years for provisional license holders to obtain an annual state license, regardless of license type. In some cases though, provisional license holders had already held a provisional license for more than three years and were still actively in the process of obtaining an annual state license. However, as we describe later, DCC lacks the needed data to evaluate the timeliness of its license review process.

The process takes significantly longer in some grantees' jurisdictions. For example, it took provisional cultivation license holders in the county of Monterey more than three years on average to obtain an annual state license, whereas the same process took only a little more than a year on average in the county of Lake. Appendix B presents additional information on the time it took DCC to process annual state license applications for each license type for applicants in each grantee's jurisdiction.

Table 6
Selected Grantees During the First Year of the Grant Program Made Varying Degrees of Progress Toward Transitioning Provisional Licenses to Annual State Licenses

			NUMBER OF PROVISIONAL LICENSE HOLDERS WHO …	
GRANTEE	USE OF GRANT FUNDS IN 2022	CONTINUING BARRIERS AND IDENTIFIED ISSUES DURING 2022	… OBTAINED ANNUAL STATE LICENSES IN 2022	… NEED TO TRANSITION TO ANNUAL STATE LICENSES AS OF JANUARY 1, 2023
City of Commerce	Salaries and benefits for new and existing employees and contract staff.	The city could not demonstrate that the hours for a contract planner working under a preexisting contract had increased or that it did not use grant funds to supplant existing cannabis funding when paying existing staff.	1	19
County of Humboldt	Staff costs to administer the grant and develop its sub-grant programs.	Humboldt did not distribute funds in 2022 through any of its grant-funded programs. Because the county spent grant funds only on staff costs in 2022, it is unlikely that Humboldt's use of grant funds contributed significantly to the percentage of provisional license holders that obtained annual state licenses.	248	597
County of Lake	Environmental contractor to assist with CEQA documentation review and planning services.	Lake's contractor assisted with its backlog of permit applications. However, the county put the contractor's work on hold because the quality of the contractor's work was not meeting the county's expectations. The county hired and trained new planning staff, and at the current rate, most of its provisional license holders will obtain annual state licenses by 2026.	53	171
City of Los Angeles	Salaries and benefits of new city employees in the cannabis regulation department.*	The city says that none of its provisional licenses transitioned to annual state licenses because its ordinance was written under the assumption that a business would obtain an annual state license before it received a local permit. Ultimately, the city had to revise its process so that a business could obtain a local permit first, but the city's application process was held up until the city council amended its local commercial cannabis ordinance, which it did in June 2023.	1	1,177
City of Santa Rosa	Staff costs for a limited-term senior planner.	The city established a position to provide assistance to commercial cannabis businesses for completing the permitting and licensing process. However, work for this position did not commence until August 2022.	9	52
County of Trinity	• Consultant to improve processing speed of CEQA analyses. • Legal support and public notifications.	The county stated that it continues to face challenges related to delays in technical aspects of its permitting process, including environmental reviews.	3	296

Source: Grantees' financial management systems, DCC's licensing data, grant agreements, and interviews with grantee staff.

* Los Angeles had not attributed these costs to the Grant Program as of October 2023.

We attempted to review DCC's licensing data to determine why it takes so long to process these applications. During the period of our review, DCC used three different data systems—the systems it inherited from the three agencies that previously regulated cannabis businesses—to manage the licensing for specific categories of cannabis businesses. DCC uses a cultivation licensing system, a manufacturing licensing system, and a system for retail, distribution, and other types of cannabis licensing (retail license system).

We expected that the three licensing data systems would each contain the information necessary to evaluate DCC's license review process. Although we found that the systems do track some information about the process, they lack key data necessary to determine why the process takes as long as it does. As an example, Figure 4 shows that the cultivation licensing system does not track all of the information necessary to determine whether long application processing times are attributable to DCC or to the applicant. For instance, it was not possible to determine from the data how long it took DCC to complete the scientific review phase, during which DCC verifies that the applicant has completed the CEQA process.

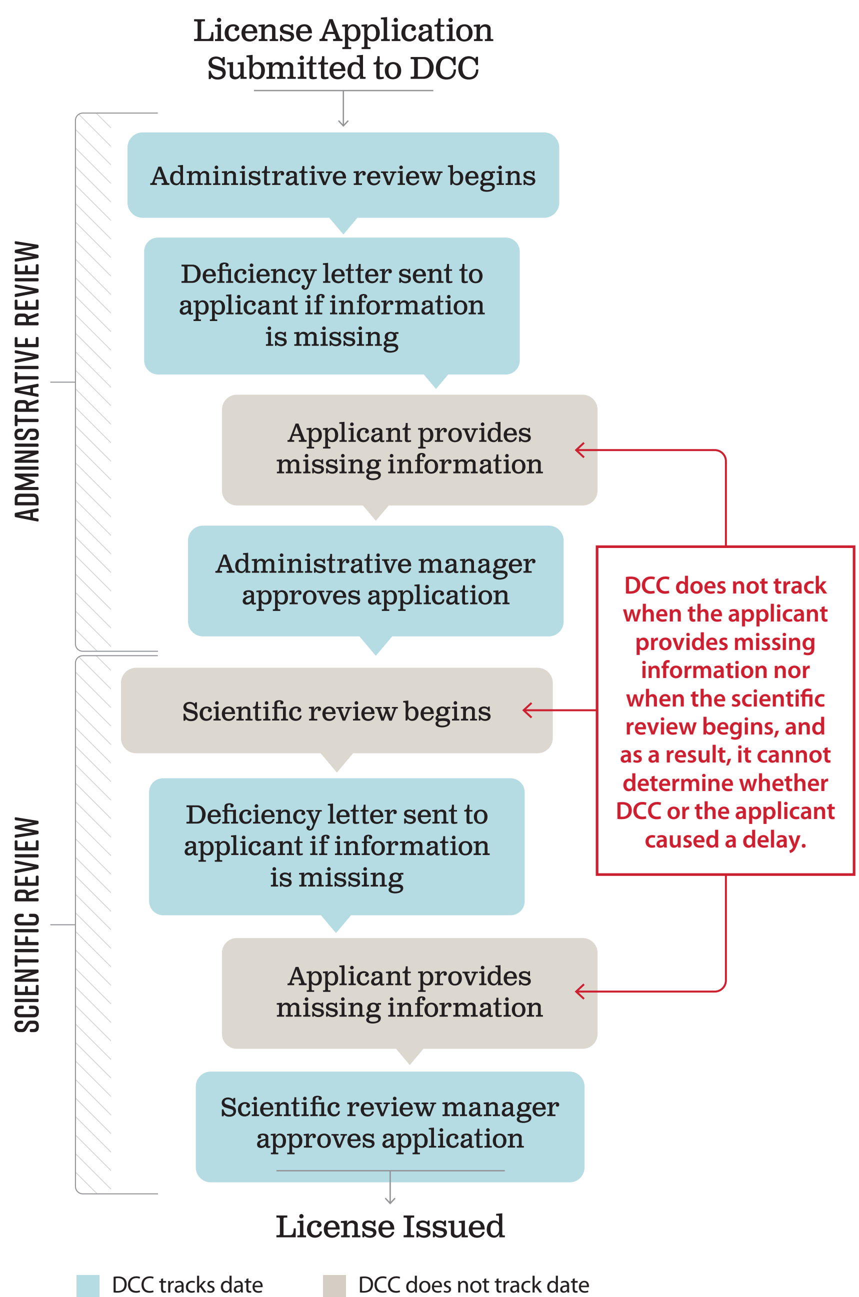
A DCC environmental supervisor described other data limitations. For instance, in the retail licensing system, when a provisional retail license changes to an annual state license, DCC staff must enter new approvals in the application's records to verify that all requirements have been met for issuing the annual state license. This action results in the environmental supervisor no longer having access to the original dates an application entered certain phases. Further, according to a supervisor in DCC's licensing division, DCC does not create or store hard copy files documenting all the relevant steps in the application process for each of the three licensing systems because all information is filed electronically.

DCC has also not completely tracked the deficiency letter process—the initial sending of the letter to an applicant outlining the information the applicant still needs to provide and the subsequent receipt of the requested documents. Figure 4 shows that although the cultivation licensing system tracks when DCC sends a deficiency letter to applicants, it does not record when applicants provide the missing information. The deputy director of DCC's licensing division confirmed that for the other two systems, DCC has either not tracked the deficiency letter process in the system or only began doing so recently.

DCC does not currently have a plan for better tracking the data necessary to evaluate the timeliness of the licensing process. However, DCC is making other changes to improve its licensing data management. DCC completed migrating the manufacturing licensing system onto the software platform used by the other cannabis licensing systems in April 2024. The deputy director of licensing said DCC also plans to modify the cultivation and retail licensing systems in spring 2024 to provide the opportunity for the two systems to more easily communicate with each other.

However, he explained that this project will not record the additional data necessary for DCC to better monitor the licensing process, even though he agreed that it would be beneficial to develop and monitor performance or processing metrics, and that DCC plans to eventually incorporate these metrics into a unified licensing system. Until it does so, DCC lacks information on the timeliness of key steps in the licensing review process, inhibiting its ability to make improvements. DCC has begun exploring the actions necessary to create a unified licensing system, and it anticipates completing these initial stages in August 2025.

Figure 4
DCC's Cultivation Licensing System Does Not Track the Dates of Certain Key Events



Source: DCC licensing data and interviews with DCC staff.

Because of these data limitations, it was not possible for us to determine the cause of the long processing times. It is likely that DCC's current application review procedures and the amount of time that applicants take to respond to DCC's requests for information contribute to the delays. DCC's environmental program manager explained that because DCC has not established any deadlines for applicants to provide missing information or unfinished documents, applicants are not pressured to provide required information in a timely manner. She told us that DCC plans to establish deadlines for applicants to provide missing information. However, she also stated that her team prioritizes new retail and distribution license applications and that they work on provisional licenses only when time permits because of a lack of time and staff.

Differences in how some grantees manage the CEQA review process may be another factor contributing to the variability in license processing times among grantees. DCC's licensing branch chief stated that the timeliness of application processing generally depends on license holders' responsiveness and compliance with CEQA, which varies by local jurisdiction. For instance, a supervisor in the licensing division explained that the county of Monterey compiles and processes CEQA documents for multiple cannabis business locations as batches, but that the county of Lake prepares CEQA documents when each cannabis business location is ready. She said that this difference in process resulted in longer initial processing times for the county of Monterey.

However, without data on when each step in the application review process begins and ends, it will be difficult for DCC to determine whether delays or variability in the length of time it takes to process applications are caused by the applicants, by the local jurisdictions, or by inefficiencies in its own processes. Because the process of obtaining an annual state license averaged nearly two years for provisional license holders who obtained an annual state license in 2022, determining the causes of any delays is important to accomplishing the purpose of the Grant Program. Tracking key dates in the licensing process in a comprehensive manner would provide DCC with the data necessary to make informed decisions about changes to its licensing process and would help DCC identify best practices for local governments to implement. For example, information about how long it takes applicants to respond to deficiency notices could help DCC determine whether setting deadlines for applicants' responses would be useful. This information could also justify hiring additional staff if DCC is unable to conduct its work in a timely manner. Moreover, analyzing processing times for applications from specific jurisdictions could help DCC identify best practices at the local level that it could share among jurisdictions.

Recommendation

DCC

To better monitor the timeliness of its license application process, by February 2025, DCC should identify the steps in the license application process, alter its license tracking systems as necessary to track relevant data related to that process, and begin analyzing the data to determine how to shorten the average time it takes to issue a license.

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Other Areas Reviewed

During the course of this audit, other issues of concern came to our attention that pertain to definitions in state law and the spending deadline that DCC has established for grantees.

Definition of Provisional License for the Grant Program

Under the Grant Program, provisional licenses are defined to include only those provisional licenses that existed on May 5, 2021. Thus, the Grant Program restricts the use of the grant funds to assisting license holders that held a provisional license as of that date. State law establishes certain dates after which provisional licenses cannot be renewed. To continue operating legally in California, all provisional license holders must eventually obtain an annual state license. For this reason, it seems counterproductive to limit the provisional licenses for which grant funds can be used. DCC stated that the May 5, 2021, date was included in the law to provide transparency about how the eligible jurisdictions were identified and that the definition in law was not intended to limit the provisional licenses on which the funds could be used. Nevertheless, in its current form, the law restricts the use of these funds to a subset of all provisional licenses.

Recommendation

Legislature

To clarify the allowable use of grant funds, the Legislature should amend the definition of a provisional license for purposes of the Grant Program to mean a provisional license issued at any time.

Spending Deadline for Grant Funds

State law requires the grant funds to be available for support or local assistance and to be available for encumbrance or expenditure until June 30, 2025. However, DCC's grant guidelines and grant agreements specify that the funds shall be spent no later than March 31, 2025. DCC's deputy director of administration explained that DCC established the March 31, 2025, deadline because DCC must complete certain procedural requirements before redistributing any recaptured funds. However, given the short lifetime of the Grant Program and the fact that grantees have been slow to spend the funds, DCC should consider changing its expenditure deadline to match the deadline established in state law.

Recommendation

DCC

To give grantees sufficient time to spend the grant funds, DCC should immediately reassess whether its March 31, 2025, spending deadline is necessary. If that deadline is not necessary, DCC should change it to the June 30, 2025, deadline established in state law.

We conducted this performance audit in accordance with generally accepted government auditing standards and under the authority vested in the California State Auditor by Government Code section 8543 et seq. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,

GRANT PARKS
California State Auditor

August 29, 2024

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Appendix A

Provisional and Annual State Licenses, January 1, 2021, Through January 1, 2023

Table A1 presents the number of provisional licenses that were active as of January 1, 2021, and January 1, 2023, respectively. The table also presents the number of provisional licenses that transitioned to annual state licenses in calendar years 2021 and 2022, as well as other additional increases and decreases that account for the difference in total provisional licenses between January 1, 2021, and January 1, 2023. These other increases and decreases include, but are not limited to, the addition of newly issued provisional licenses and the subtraction of other provisional licenses that became inactive during the period we reviewed. Furthermore, because of limitations in the manufacturing licensing system, it was not possible to determine the number of provisional manufacturing licenses that were active as of January 1, 2021, or the number of provisional manufacturing licenses that transitioned to annual state licenses during calendar year 2021. However, the data show that in certain grantees' jurisdictions, only a few provisional license holders obtained annual state licenses during calendar years 2021 and 2022. Table A2 presents the number of annual state licenses that were active as of January 1 of calendar years 2021, 2022, and 2023, respectively. The data limitations for the manufacturing license system that apply to Table A1 also apply to Table A2 and to the numbers of annual state licenses.

Table A1
Summary of Provisional Licenses

	ACTIVE PROVISIONAL LICENSES AS OF JANUARY 1, 2021*	PROVISIONAL LICENSES TRANSITIONED TO ANNUAL IN 2021*	PROVISIONAL LICENSES TRANSITIONED TO ANNUAL IN 2022†	OTHER INCREASES AND (DECREASES) IN PROVISIONAL LICENSES ‡	ACTIVE PROVISIONAL LICENSES AS OF JANUARY 1, 2023§
City of Adelanto	64	(9)	(7)	70	118
City of Commerce	13	0	(1)	7	19
City of Desert Hot Springs	49	(8)	(4)	59	96
County of Humboldt	1,120	(132)	(248)	(143)	597
County of Lake	265	(83)	(53)	42	171
City of Long Beach	109	(12)	(8)	48	137
City of Los Angeles	650	0	(1)	528	1,177
County of Mendocino	872	(15)	(4)	(88)	765
County of Monterey	509	(6)	(13)	(98)	392
County of Nevada	130	(28)	(49)	38	91
City of Oakland	317	(55)	(35)	78	305
City of Sacramento	195	(33)	(69)	67	160
City of San Diego	47	(5)	(9)	22	55

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	ACTIVE PROVISIONAL LICENSES AS OF JANUARY 1, 2021*	PROVISIONAL LICENSES TRANSITIONED TO ANNUAL IN 2021*	PROVISIONAL LICENSES TRANSITIONED TO ANNUAL IN 2022†	OTHER INCREASES AND (DECREASES) IN PROVISIONAL LICENSES ‡	ACTIVE PROVISIONAL LICENSES AS OF JANUARY 1, 2023§
City and County of San Francisco	111	(13)	(18)	(10)	70
City of Santa Rosa	47	(12)	(9)	26	52
County of Sonoma	120	(1)	(4)	(9)	106
County of Trinity	315	(11)	(3)	(5)	296
Totals	**4,933**	**(423)**	**(535)**	**632**	**4,607**

Source: Analysis of DCC's manufacturing, cultivation, and retail and distribution licensing systems.

Note: Our analysis of the retail and distribution licensing system also includes testing and microbusiness licenses.

* Because of limitations in the manufacturing licensing system, manufacturing licenses are excluded from the count of provisional licenses that were active as of January 1, 2021.

† Manufacturing licenses are included in the count of provisional licenses that transitioned to annual state licenses during 2022. They add seven licenses to the total count.

‡ Other reasons influencing the net change in the count of provisional licenses between January 2021 and January 2023 that are not explained by provisional licenses transitioning to annual state licenses include the following: the addition of newly issued provisional licenses; the removal of licenses that have entered inactive status for reasons such as the license holder surrendering the license or not renewing the license; and the addition of manufacturing license data in 2022 and 2023 that are not present in the analysis for 2021 because of data limitations. The addition of manufacturing license data adds approximately 400 licenses to the count of provisional licenses that were active as of January 1, 2023.

§ Because of inconsistent information contained in the manufacturing licensing system and printed on the license certificates, we were unable to discern whether seven licenses that were still active as of January 1, 2023, were in provisional or annual status. We counted them as provisional for the purpose of this table.

Table A2
Summary of Annual State Licenses

	ACTIVE ANNUAL STATE LICENSES*		
	AS OF JANUARY 1, 2021†	AS OF JANUARY 1, 2022‡	AS OF JANUARY 1, 2023‡
City of Adelanto	18	41	60
City of Commerce	0	2	8
City of Desert Hot Springs	22	37	37
County of Humboldt	434	743	1,004
County of Lake	46	176	143
City of Long Beach	2	38	52
City of Los Angeles	0	0	4
County of Mendocino	8	22	25
County of Monterey	26	56	58
County of Nevada	1	41	107
City of Oakland	12	91	119
City of Sacramento	32	95	182
City of San Diego	3	18	24
City and County of San Francisco	6	37	69
City of Santa Rosa	9	39	58
County of Sonoma	7	17	23
County of Trinity	88	103	89
Totals	714	1,556	2,062

Source: Analysis of DCC's manufacturing, cultivation, and retail and distribution licensing systems.

Note: Our analysis of the retail and distribution licensing system also includes testing and microbusiness licenses.

* Reasons why the count of annual state licenses that are in active status changes over time include the following: provisional license holders may transition to an annual state license; an applicant may obtain an annual state license immediately without first obtaining a provisional license; and annual state licenses may become inactive for several reasons, including if the license holder surrenders the license or does not renew the license.

† Because of limitations in the manufacturing licensing system, manufacturing licenses are excluded from the count of active licenses as of January 1, 2021.

‡ Because of inconsistent information contained in the manufacturing licensing system and printed on the license certificates, we were unable to discern whether eight licenses that were active as of January 2022 or January 2023 were in provisional or annual status. We did not count them as annual state licenses for the purpose of this table.

Appendix B

License Processing Times

We obtained data from DCC to determine the average time it took for a provisional licensee to obtain an annual state license in each of the grantees' jurisdictions, by license type. Using these data, we identified all provisional licenses that had transitioned to annual state licenses and the length of time between the date the provisional license was obtained and the date the annual state license was obtained. For each type of license, we also identified the active provisional licenses that had not yet transitioned to an annual state license and the length of time these license applications had been in process, beginning from the date the provisional license was obtained.

For the purpose of this analysis, we identified provisional licenses that had transitioned to annual state licenses, as well as provisional licenses that were still active, as of the date we obtained the data. Because of limitations in the manufacturing licensing system, we only present the processing times for provisional manufacturing licenses that had transitioned to annual state licenses during 2022. Tables B1, B2, and B3 present our results by license type. The numbers in these tables may not match the numbers presented in Appendix A because Appendix A only includes activity for certain periods.

Table B1
Average Processing Times for Cultivation Licenses for Jurisdictions in the Grant Program

JURISDICTION	CULTIVATION LICENSES			
	SUCCESSFUL TRANSITIONS		PENDING TRANSITIONS	
	NUMBER OF PROVISIONAL LICENSES TRANSITIONED TO ANNUAL STATE LICENSES	AVERAGE NUMBER OF CALENDAR DAYS TO TRANSITION TO AN ANNUAL STATE LICENSE	NUMBER OF PROVISIONAL LICENSES THAT HAVE YET TO TRANSITION TO AN ANNUAL STATE LICENSE	AVERAGE NUMBER OF CALENDAR DAYS THAT ANNUAL STATE LICENSE APPLICATIONS HAVE BEEN IN PROCESS
City of Adelanto	8	554	59	825
City of Commerce	0	–	0	–
City of Desert Hot Springs	5	458	26	758
County of Humboldt	503	738	460	1,186
County of Lake	149	459	126	648
City of Long Beach	5	533	21	920
City of Los Angeles	0	–	290	971
County of Mendocino	18	954	627	1,095
County of Monterey	96	1,161	235	1,123
County of Nevada	91	604	61	811
City of Oakland	8	542	88	667
City of Sacramento	46	686	32	891
City of San Diego	0	–	3	634
City and County of San Francisco	2	792	11	1,357
City of Santa Rosa	8	542	2	1,346
County of Sonoma	7	536	78	1,018
County of Trinity	59	570	249	982
Total Number of Licenses	**1,005**	–	**2,368**	–
Average Number of Calendar Days	–	**708**	–	**1,025**

Source: Analysis of DCC's cultivation licensing system as of May 2023.

Table B2
Average Processing Times for Manufacturing Licenses for Jurisdictions in the Grant Program

JURISDICTION	MANUFACTURING LICENSES			
	SUCCESSFUL TRANSITIONS		PENDING TRANSITIONS	
	NUMBER OF PROVISIONAL LICENSES TRANSITIONED TO ANNUAL STATE LICENSES*	AVERAGE NUMBER OF CALENDAR DAYS TO TRANSITION TO AN ANNUAL STATE LICENSE*	NUMBER OF PROVISIONAL LICENSES THAT HAVE YET TO TRANSITION TO AN ANNUAL STATE LICENSE	AVERAGE NUMBER OF CALENDAR DAYS THAT ANNUAL STATE LICENSE APPLICATIONS HAVE BEEN IN PROCESS
City of Adelanto	1	407	19	938
City of Commerce	0	–	3	1,178
City of Desert Hot Springs	0	–	18	1,037
County of Humboldt	1	814	3	573
County of Lake	0	–	0	–
City of Long Beach	1	478	28	970
City of Los Angeles	0	–	235	959
County of Mendocino	1	462	1	191
County of Monterey	0	–	4	1,026
County of Nevada	0	–	0	–
City of Oakland	2	819	41	1,012
City of Sacramento	0	–	18	695
City of San Diego	0	–	12	752
City and County of San Francisco	0	–	1	1,168
City of Santa Rosa	0	–	13	862
County of Sonoma	1	1,198	1	1,310
County of Trinity	0	–	0	–
Total Number of Licenses	**7**	–	**397**	–
Average Number of Calendar Days	–	**714**	–	**945**

Source: Analysis of DCC's manufacturing licensing system as of January 2023.

* Because of limitations in the manufacturing licensing system, we present information related only to provisional licenses that transitioned during calendar year 2022.

Table B3

Average Processing Times for Retail and Distribution Licenses for Jurisdictions in the Grant Program

	RETAIL AND DISTRIBUTION LICENSES			
	SUCCESSFUL TRANSITIONS		PENDING TRANSITIONS	
JURISDICTION	NUMBER OF PROVISIONAL LICENSES TRANSITIONED TO ANNUAL STATE LICENSES	AVERAGE NUMBER OF CALENDAR DAYS TO TRANSITION TO AN ANNUAL STATE LICENSE	NUMBER OF PROVISIONAL LICENSES THAT HAVE YET TO TRANSITION TO AN ANNUAL STATE LICENSE	AVERAGE NUMBER OF CALENDAR DAYS THAT ANNUAL STATE LICENSE APPLICATIONS HAVE BEEN IN PROCESS
City of Adelanto	13	427	32	1,010
City of Commerce	7	760	8	834
City of Desert Hot Springs	14	444	48	1,034
County of Humboldt	61	588	24	1,137
County of Lake	2	307	7	507
City of Long Beach	29	981	75	1,033
City of Los Angeles	2	1,190	659	906
County of Mendocino	20	552	56	964
County of Monterey	5	995	41	1,213
County of Nevada	1	188	10	841
City of Oakland	107	566	168	903
City of Sacramento	98	691	68	1,034
City of San Diego	42	899	12	1,076
City and County of San Francisco	47	801	44	1,324
City of Santa Rosa	27	486	30	1,185
County of Sonoma	4	602	10	1,346
County of Trinity	6	379	13	992
Total Number of Licenses	**485**	–	**1,305**	–
Average Number of Calendar Days	–	**664**	–	**966**

Source: Analysis of DCC's retail and distribution licensing system as of April 2023.

Note: Our analysis of the retail and distribution licensing system also includes testing and microbusiness licenses.

Appendix C

Scope and Methodology

We conducted this audit pursuant to the audit requirements contained in state law.[7] The law requires our office to conduct a performance audit of the local jurisdictions receiving funds pursuant to the Grant Program, commencing January 1, 2023, and annually until January 1, 2026. Table C1 lists the audit objectives and the methods we used to address them. Unless otherwise stated in the table or elsewhere in the report, statements and conclusions about items selected for review should not be projected to the population.

Table C1
Audit Objectives and the Methods Used to Address Them

	AUDIT OBJECTIVE	METHOD
1	Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed the laws, rules, and regulations related to the Grant Program and state cannabis licenses.
2	Assess progress toward the goals of the Grant Program by determining the following for each of the 17 grantees:	
	a. The amount and percent of grant funds used as of December 31, 2022.	• Obtained and analyzed financial reports from the 17 grantees to determine the amount of grant funds received and used as of December 31, 2022. • Interviewed grantee staff and reviewed relevant documentation to evaluate safeguards over the grant funds. • Judgmentally chose a non-statistical selection of expenditures from the grantees' financial reports. Interviewed staff, reviewed the grant agreements and applicable laws, and analyzed relevant documentation to determine the allowability of these expenditures. We identified certain weaknesses in three grantees' supporting documentation that called into question the allowability of their expenditures, and we separately communicated our concerns to their management. We also found that one grantee used an insignificant amount of grant funds for a purpose that was not allowable. After we raised our concerns about the expenditure, the grantee reimbursed the expenditure with another source of funding.
	b. The number of provisional state licenses and the number of annual state licenses as of January 1, 2021, 2022, and 2023.	Evaluated data from the three cannabis licensing systems to identify when the State issued provisional and annual state licenses to businesses in each of the 17 jurisdictions. Because the manufacturing licensing system does not capture the date when a license transitioned from provisional to annual, we were unable to tell whether certain manufacturing licenses were provisional or annual on January 1, 2021. When DCC became responsible for cannabis licensing in July 2021, it started generating monthly reports from the manufacturing licensing system to track which licenses had transitioned from provisional to annual. We relied upon these reports to identify the number of provisional and annual manufacturing licenses as of January 1, 2022, and January 1, 2023.

continued on next page . . .

7 Senate Bill 129 (Stats. 2021, ch. 69), section 53, provision 11.

	AUDIT OBJECTIVE	METHOD
3	For a selection of grantees, obtain the grantee's perspective on which actions helped to streamline its permitting process, why they have not made more progress, and how they plan to address the issues they describe in their grant applications.	• Using the February 2023 biannual report data submitted to DCC, judgmentally selected six grantees—the counties of Humboldt, Lake, and Trinity, and the cities of Commerce, Los Angeles, and Santa Rosa—based on the amount of grant funds spent and the rate that provisional license holders obtained annual state licenses. • Interviewed staff at each of the six selected grantees and reviewed their February 2023 and August 2023 biannual reports to determine which actions helped them streamline their permitting processes, why they have not made more progress, and how they plan to address the issues they describe in their grant applications.
4	Determine if DCC is processing applications for annual state licenses from these 17 grantees in a timely manner and whether any patterns exist in terms of grantees that have had a large percentage of applications rejected.	• Evaluated data from the three cannabis licensing systems to determine how much time passed from the date a business was issued a provisional license to the date it was issued an annual state license. • Interviewed DCC staff about how DCC processes applications and the factors that may contribute to its long processing times and differences among the processing times for the grantees' jurisdictions.
5	Assess DCC's oversight and administration of the Grant Program, including its controls to ensure funds are spent appropriately and its measures of success for the program.	• Identified amendment requests submitted by grantees in 2022 and calculated the amount of time it took DCC to approve or deny the requests. Interviewed staff at DCC concerning the causes of any excessive processing times. • Interviewed staff and reviewed relevant documentation concerning DCC's process for monitoring grant expenditures to determine whether DCC ensures that the grantees use the grant funds for allowable purposes. • Reviewed the biannual report templates and instructions DCC provided to the grantees as well as the August 2022 and February 2023 biannual reports submitted by grantees to determine whether the biannual report data allow DCC to measure the effectiveness of the Grant Program. • Interviewed DCC staff to obtain perspective on DCC's plans to measure the Grant Program's success. • Obtained financial documentation showing how DCC is spending its appropriation for administering the program to determine whether its expenditures are allowable and whether it used these funds effectively.

Source: Audit workpapers.

Assessment of Data Reliability

The U.S. Government Accountability Office, whose standards we are statutorily obligated to follow, requires us to assess the sufficiency and appropriateness of computer-processed information we use to support our findings, conclusions, or recommendations.

DCC

In performing this audit, we relied on data that DCC provided from its three cannabis licensing systems. To evaluate these data, we reviewed existing information about the data, interviewed department officials knowledgeable about the data, and performed electronic testing of the data. Although we identified several issues in our testing, we took steps to manually correct for them in our analysis. However, as a result of changes to the ways the licensing systems have been managed over time, we were unable to gain assurance that all of the cannabis licenses issued are recorded in the data. Further, because of the way in which manufacturing licenses were issued and how DCC maintains documentation supporting the manufacturing licenses, we were unable to obtain assurance of the accuracy of key data from this system. As a result, we found the data from the three cannabis licensing systems to be of undetermined reliability. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings, conclusions, and recommendations.

Grantees

To determine the amount and percentage of grant funding used by the grantees as of December 31, 2022, we relied on data that the 17 grantees provided from their financial systems and other sources. Table C2 describes the information systems from which the data came, our methods for testing them, and the results of our assessment.

Table C2
Methods Used to Assess Data Reliability

INFORMATION SYSTEM	METHOD AND RESULT	CONCLUSION
City of Adelanto *(New World financial and administrative management software)* **County of Lake** *(Naviline accounting system)* **County of Mendocino** *(Munis Enterprise Resource Planning)* **County of Monterey** *(SAP Enterprise Resource Planning System)* **County of Nevada** *(eFinancePlus financial system)* **City of Sacramento** *(PeopleSoft Enterprise Performance Management System)* **City of Oakland** *(Oracle Financial System R12)* **City of San Diego** *(SAP Enterprise Resource Planning System)* **City and County of San Francisco** *(PeopleSoft Enterprise Performance Management System)* **City of Santa Rosa** *(One Solution Enterprise Resource Planning System)* **County of Sonoma** *(PeopleSoft Enterprise Performance Management System)*	We performed dataset verification procedures and electronic testing of key data elements and did not identify any issues. We performed accuracy testing either by reviewing all transactions or by using invoices to haphazardly select a sample of transactions and tracing key data elements to supporting documentation, and we found no material errors. We did not perform completeness testing of these data because of time and budgetary constraints.	We found the data from each grantee's system to be of undetermined reliability for the purpose of determining the amount and percentage of grant funding used as of December 31, 2022, because we did not determine whether the data were complete. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings, conclusions, and recommendations.

continued on next page . . .

INFORMATION SYSTEM	METHOD AND RESULT	CONCLUSION
City of Long Beach *(Munis Enterprise Resource Planning)* **County of Trinity** *(One Solution Enterprise Resource Planning System)*	We performed dataset verification procedures and electronic testing of key data elements and did not identify any issues. We performed accuracy testing of transactions by tracing key data elements to supporting documentation, and we found two errors at each entity that affected the dates for which each grantee was recording expenditure transactions. We did not perform completeness testing of these data because of time and budgetary constraints.	We found the data from each grantee's financial system to be understated for the purpose of determining the amount and percentage of grant funding used as of December 31, 2022, because not all expenditures had been recorded in the correct period. Although this determination may affect the precision of the numbers we present, there is sufficient evidence in total to support our findings, conclusions, and recommendations.
City of Commerce *(Commerce's biannual report to DCC, February 2023)*	The city did not record its grant expenditures in its financial system for calendar year 2022 and only tracked these expenditures in its biannual reports to DCC. Because of the lack of supporting documentation and the unreliable methodology the city used to generate these data, we did not perform any additional steps to assess the reliability of the data.	We found the city's biannual report to DCC to be not sufficiently reliable for the purpose of identifying the city's total amount of grant expenditures.
City of Desert Hot Springs *(OpenGov financial management system)*	Following our review of preliminary documentation and subsequent conversations with city staff, we found that the city had not spent any of its grant funds.	We determined that because the city had not spent any grant funds, a data reliability assessment of its financial system was unnecessary.
County of Humboldt *(CentralSquare Finance Enterprise system)*	Following our review of preliminary documentation and subsequent conversations with county staff, we identified a discrepancy of approximately $1,700 in the underlying documentation supporting the transactions recorded in the financial system, and therefore we determined that additional data reliability procedures were unnecessary.	We found the county's financial system data to be not sufficiently reliable for the purpose of determining the amount and percentage of grant funding used.
City of Los Angeles *(Financial Management System)*	Following our review of preliminary documentation and subsequent conversations with city staff, we found that the city had not yet charged any expenditures to the grant in its accounting system.	We determined that because the city had not recorded any expenditures to the grant in its accounting system, a data reliability assessment of that system was unnecessary.

Source: Analysis of documents, interviews, and data from the 17 grantees.

CITY OF
LONG BEACH

Office of the City Manager
411 W. Ocean Blvd., 10th Floor, Long Beach, CA 90802
(562) 570-5250 FAX (562) 570-5250

August 1, 2024

Grant Parks
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

RE: 2023-048 – Confidential Draft Audit Report for Review

The City of Long Beach has reviewed the confidential draft audit report for the Local Jurisdiction Assistance Grant and would like to provide a written response as follows:

The City of Long Beach 1) agrees with the recommendation; and 2) improved its ability to appropriately track expenditures by requiring interdepartmental costs to be transferred to the grant budget on a quarterly basis or sooner (depending on the grant reporting period), in alignment with the City's standard accounting procedures.

If you have any questions, please contact Valencia Romero at (562) 570-8173 or by email at valencia.romero@longbeach.gov. Thank you kindly.

Sincerely,

Valencia Romero

Valencia Romero
Manager of Cannabis Oversight/Assistant to the City Manager

Blank page inserted for reproduction purposes only.

July 31, 2024

Grant Parks, California State Auditor
621 Capitol Mall, Suite 1200
Sacramento CA 95814
Email: VanceC@auditor.ca.gov

RE: City of San Diego Response to **2023-048**—Confidential Draft Audit Report

Thank you for the opportunity to review and respond to the confidential audit report for the G21-014 DCC Local Jurisdiction Assistance Grant that was awarded to the City of San Diego in 2021. The City of San Diego requests that the report should include language that reflects that the subject $6,000 line item for translation and room rental costs have been reversed and are no longer included in the grant expenditures. Please see attached screenshot included as Attachment 1.

Should you have questions, please contact me at Lngates@sandiego.gov.

Sincerely,

Lara Gates

Lara Gates
Deputy Director
Development Services Department

ATTACHMENT: 1. Screenshot of Translation/Room Rental Costs

CC: Eric Dargan, Chief Operating Officer, Office of the Mayor
Casey Smith, Deputy Chief Operating Officer, Office of the Mayor
Elyse Lowe, Director, Development Services Department
Luis Briseno, Program Manager, Compliance Department

ATTACHMENT 1

RE: 2023-048 Audit - Draft report

BN Biendarra, Nanci
To Gates, Lara
Cc Khalil, Bouthayna
Retention Policy 5 Year Retention (Inbox) (5 years)
You replied to this message on 7/29/2024 2:46 PM.

Hi Lara,

Yes, JE 103391876 was processed which moved $6,403.82 form the grant.

Grants Management: Line Item Display

Grant	Sponsored Program	Fund	Order	Sp. Cla..	BuValNbr.	Year	Period	RefDocumnt	VT	Pstng Date	¤	Tran. Crcy	Crcy	D	DT.
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2022	12	5001280820	99	06/02/2022		2,702.22	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2022	12	5001288777	99	06/27/2022		310.00	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2022	12	5001288777	99	06/27/2022		310.00	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2022	12	5001288777	99	06/27/2022		310.00	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2022	12	5001288777	99	06/27/2022		104.13	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2022	12	5001288777	99	06/27/2022		1,625.00	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2022	12	5001288777	99	06/27/2022		310.00	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2022	12	5001288777	99	06/27/2022		310.00	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2022	12	5001288777	99	06/27/2022		310.00	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2023	2	5001304052	99	08/10/2022		112.50	USD	S	WE
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2024	11	103391876	66	05/24/2024		112.50-	USD	S	SA
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2024	11	103391876	66	05/24/2024		3,589.13-	USD	S	SA
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2024	11	103391876	66	05/24/2024		2,702.22-	USD	S	SA
100...	DIRECT TECH- OTHERS	710...	AB1000727-22	SUPPLI...	010	2024	12	103423756	66	06/24/2024		4,557.76	USD	S	SA
	DIRECT TECH- OTHERS		**AB1000727-22**								▪	**4,557.76**	**USD**		
											▪▪	**4,557.76**	**USD**		

Thanks again,

Nanci Biendarra
Senior Management Analyst
City of San Diego
Development Services Dept.
619-236-6007

Department of Cannabis Control
CALIFORNIA

Gavin Newsom
Governor

Nicole Elliott
Director

August 1, 2024

Mr. Grant Parks*
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 5814

Subject: Response to Draft Report No. 2023-048

Dear Mr. Parks:

Thank you for the opportunity to respond to the draft of the California State Auditor's (CSA) Report No. 2023-048 titled "*Cannabis Business Licensing – Inadequate Oversight and Inappropriate Expenditures Weaken the Local Jurisdiction Assistance Grant Program*".

We appreciate the effort that CSA's audit team has taken in seeking to understand and review the Department of Cannabis Control's (DCC or Department) performance concerning the administration and oversight of the Local Jurisdiction Assistance Grant (LJAG) Program. Further, we do recognize the value of CSA's recommendations, especially as the organization continues to grow and mature.

DCC was established on July 12, 2021, through Assembly Bill 141 (2021) at the same time the LJAG Program was established through Senate Bill 129 (2021). The Department was tasked with merging staff, unifying programs, and creating a single regulatory framework for commercial cannabis in California. While laying the foundation for its most essential business operations, the Department simultaneously rose to the challenge of setting up an operational grants management program, during a global pandemic, and in a remote work environment.

These circumstances inspire the DCC to provide additional context and clarification to CSA's observations and findings to underscore the extent of efforts and progress made by the Department since its own inception, the inception of the LJAG Program, and throughout the time of this audit. Please see table below. Where the DCC respectfully suggests reconsideration of some characterizations or observations in the report, it does so based on the evidence provided to CSA during the audit.

Summary Section		
CSA Observation	DCC Response	1
After we informed DCC through a July 2023 management letter about its staffs' inexperience, as well as the other identified problems in its grant management and use of the administrative funds, DCC took immediate action to address some	Since May 2024, DCC's Administration Division has developed a DCC Grant Management Manual that includes guidance on the recommendations identified in the report.	2

* California State Auditor's comments begin on page 67.

Mr. Grant Parks
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of these issues. However, as of May 2024, other issues with DCC's grant management practices remain unresolved.	
In addition, despite experiencing licensing processing time that take on average two years, DCC did not track key steps in its licensing process that would have allowed it to analyze those steps that contribute most to delays and identify solutions to mitigate delays in its process. The lack of data and documentation on when steps in the application process are completed prevented us from analyzing the potential causes for delays in processing times.	During the first year of the grant program, DCC was operating from three different licensing systems as a result of the department reorganization that became effective on July 12, 2021. The Department has since moved into two licensing systems and is beginning to take the necessary steps to support a transition to one system. While the Department can manually track when it closes key tasks to transition applications from one phase to another (administration to science review), the systems cannot track how many days each of the subtasks takes, including staff time to review content.

Chapter 1, Condition 1 – One Grant Agreement DCC Approved Included Plans That Did Not Align With the Grant Program's Purpose	
CSA Observation	DCC Response
When we raised this issue with DCC, its staff responded that it understood the county's sub-grants to commercial cannabis license holders were intended to aid license holders who held provisional permits to meet the county's conditions for approval. However, the county's grant agreement clearly states that some applicants for these sub-grants already held an annual state license, and the Grant Program funds were to support local jurisdictions in aiding provisional license holders with meeting the requirements to attain an annual state license.	All Humboldt County operators are required to obtain a provisional permit from the County. The County's ordinances incorporate eligibility criteria and performance standards, which are applied as conditions for two years. These conditions are designed to reduce potential environmental effects, including those related to water supply (i.e., water diversions/groundwater wells) and air quality/greenhouse gasses (i.e., the use of generators). When these conditions are not fulfilled, the County will revoke the permit. When operators with a state provisional license agree to these conditions, the County informs the Department that such provisional licensees are eligible for transition to annual licensure. The Department has determined that Humboldt County's competitive grant programs related to Stream Protection and Renewable Energy are intended to aid in its local provisional permittees fulfilling their outstanding conditions related to environmental compliance, thereby enabling them to attain and maintain annual state licensure. Accordingly, the Department has determined that the County's competitive grant programs are considered eligible uses and costs as identified in the Budget Act of 2021, Item 1115-101-0001, for the following reasons:

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	• The competitive grant programs fund mitigation measures related to environmental compliance, including water conservation and protection measures; and • The competitive grant programs are considered uses that further the intent of the program.

Chapter 1, Condition 2 – DCC's Management of the Grant Program Has Not Aligned with Best Practices		
CSA Observation	DCC Response	
DCC's director provided context on why DCC chose to disburse 80 percent of the funds upfront, stating DCC's belief that the Legislature intended it to promptly distribute the grant funds to allow local jurisdictions to meet the deadlines in state law. It is unclear why grantees would need the funds immediately if their planned activities required significant lead time, and the chief deputy director confirmed that DCC did not verify whether grantees actually needed the funds so quickly.	When adopting final statutory changes to Section 26050.2 as a part of Senate Bill 160 (2021), related to provisional licensing timelines, the Legislature incorporated the following intent statement: "(r) It is the intent of the Legislature that funds appropriated in Item 1115-101-0001 of the Budget Act of 2021 **shall be promptly deployed** [emphasis added] to allow local jurisdictions to meet the deadlines in this Act." The Department read that intent statement literally and acted promptly, as DCC believes the Legislature directed the Department to do. The LJAG Program was established against a backdrop of significant time pressure. Senate Bill 129 (2021), which created the LJAG Program to help transition provisional cannabis licenses to annual licenses, was enacted at the same time as Senate Bill 166 (2021), which established tight deadlines for completing that transition. Under Senate Bill 166 (2021), provisional licenses—which were then 67% of all state commercial cannabis licenses—would need to meet enhanced licensing requirements beginning less than a year after the bills were chaptered. Senate Bill 51 (2023), signed by the Governor on October 8, 2023, further refined these requirements. As CSA alluded to, it was understood during the legislative process that LJAG funds would need to be deployed quickly to help meet those tight deadlines. For LJAG funds to be deployed quickly, it was necessary for DCC to ensure that those funds were swiftly disbursed to recipient local jurisdictions. Reflecting this shared understanding, the Legislature streamlined DCC's ability to disburse those funds by specifying recipient jurisdictions directly in Senate Bill 129 (2021), and by further specifying the amount that each jurisdiction was eligible to receive. Consistent with this shared understanding of the need to move quickly, DCC worked as quickly as possible to provide each jurisdiction with 80% of those available funds.	4

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	Before disbursing the funds, DCC communicated with local jurisdictions to ensure that jurisdictions would be ready to use LJAG funds productively. During the development of the LJAG Program guidelines, DCC staff met with representatives of each eligible jurisdiction to better understand their specific resource needs. Eligible jurisdictions were also invited to submit feedback on the draft LJAG guidelines; DCC's guidelines were modified in response to that input. During this engagement, local jurisdictions independently affirmed that they needed to receive funds in advance, considering their need to meet the tight deadlines in Senate Bill 166 (2021). DCC swiftly disbursed LJAG funds to recipient local jurisdictions and provided them with the greatest opportunity to support the transition of provisional to annual licenses during the short period for the grant program. Once they received LJAG funds, local jurisdictions needed to work quickly to ensure those funds were spent consistently with the purposes of the LJAG Program and the timeframes in Senate Bill 166 (2021).
The grant guidelines from October 2021 state that DCC would distribute the remaining 20 percent of the grant funds awarded to grantees, an amount totaling approximately $19 million, after grantees had substantially met the goals and intended outcomes in their annual plans. However, DCC did not define this term in the guidelines, leaving the grantees without a metric for demonstrating that they have met the benchmark and leaving DCC without a metric for evaluating whether grantees have met the benchmark. DCC's former grants manager explained that DCC would begin considering the issue after the August 2023 biannual reports were submitted. By November 2023, the operations branch chief explained that DCC was preparing instructions for grantees on how to submit a request for the remaining grant funds, which DCC sent to grantees in April 2024.	Between January 2024 and April 2024, DCC initiated technical assistance meetings with each jurisdiction to provide detailed feedback on their deliverables, budget expenditures, allowable use of funds, and eligibility to request the balance (20%) of their award.

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Chapter 1, Condition 3 – Some Grantees' Spending Was Delayed by DCC's Protracted Responses to Their Amendment Requests	
CSA Observation	DCC Response
DCC's former grants manager attributed such delays to various factors, such as staff turnover, grantees' struggles to properly address grant agreements, an inefficient process for gathering requested information, a lack of DCC and grantee staff, and her need to prioritize other tasks. She also stated that the exhibit that set forth the 10-business day deadline had been included in the agreements in error and would be removed in subsequent amendments to the agreements, and she contended that having deadlines for amendment determinations were not feasible because of insufficient staffing.	Since July 2024, DCC's Office of Grants Management (OGM) has removed the conflicting language from seven grant agreements. Meanwhile, four grant agreements are in the process of being closed out and six other grant agreements are being amended to remove this language. Furthermore, as of July 1, 2024, DCC has staffed its OGM with a grants manager and four grant management analysts to expedite reviews and processing times of amendments. 2

Chapter 1, Condition 4 – To Improve Its Management of the Grant Program, DCC Could Have More Efficiently Used the Administrative Funds It Was Appropriated	
CSA Observation	DCC Response
Although the budget act took effect in July 2021, DCC's deputy director of administration explained that DCC did not establish its OGM until January 2022. More than a year later, it was staffed in May 2023 with only a single grants manager to handle all 17 jurisdictions. Our interviews with DCC management suggest that there was a lack of effective internal communication about the insufficient resources and no plan in place to evaluate staffing needs. The chief deputy director told us in May 2023 that she was not aware of any problems with administering or overseeing the grant or	The Department was created on July 12, 2021. DCC established its Office of Grants Management (OGM) in January 2022. During the creation of the Department, no grants management staff were acquired from the three legacy programs. Therefore, the Department had to recruit and hire grant staff. The first recruitment resulted in a manager being hired in June 2022 and an analyst in August 2022. Since then, OGM has continued its recruitment by hiring three additional analysts and one retired annuitant analyst to support the LJAG program. Grant agreements were executed between January 2022 and March 2022 with the first biannual reporting period occurring in August 2022. Following the August 2022 Biannual Reporting Period, and as a result of effective internal communication, DCC requested resources, including provisional hiring authority, to support OGM's resource needs. The Legislature denied this request. DCC then

Mr. Grant Parks
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grantees because of insufficient staff.	sought to establish limited term positions and encountered challenges filling these positions due to the limited-term nature of the recruitment.

Chapter 3, Condition 1 – The Rate of Progress During the Program's First Year Raises Concerns About Whether the Grant Program Can Achieve Its Purpose	
CSA Observation	DCC Response
During the first year of the Grant Program's four-year lifespan, grantees made limited progress towards the program's primary purpose of assisting provisional license holders to obtain an annual state license…During 2022 – the first year of the Grant Program – only 535 provisional license holders obtained an annual license. If DCC continued to issue the same number of annual state licenses to provisional license holders as it did during 2022, more than half of the provisional license holders in the grantees' jurisdictions will still not have obtained an annual state license by 2026.	The rate at which provisional licensees convert to annual licensees is a lagging metric and is not fully indicative of the progress being made as a result of this program. This includes outcomes eliminating difficulties/barriers to obtaining an annual license. Local jurisdictions eligible to receive grant funding represent those with significant numbers of provisional licenses who are legacy and equity applicants, and provisional licensees that are more likely to have arduous environmental compliance requirements associated with CEQA. The reasons grantees did not spend funding in the first year of grant implementation vary. Some grantees needed to enter into contract agreements, hire staff, or purchase field equipment, all of which take time to process prior to showing up on expenditures. Others had turnover in their administration or revisions to their local codes (for example, Los Angeles and Mendocino) which caused delays. Further, all jurisdictions have variables impacting licensure timelines that the Department does not have any ability to control. For example, in the City of Los Angeles – a jurisdiction representing 21.6% of all provisional licensees (1,009 provisional licenses of 4,667 total provisional licenses) eligible to be impacted by the LJAG Program as of January 1, 2022 – numerous licensees must achieve several levels of approval at the local jurisdiction level, including community and Area Planning Commission approval, before being approved for state annual licenses. 5 Overall, the Department has increased the number of transitions from provisional to annual licenses since the period under audit as evidenced by the data below which shows the number of licenses DCC has transitioned from provisional to annual licensure: • FY 2021-22: 934 • FY 2022-23; 1,458 • FY 2023-24: 1,237 • FY 2024-25: 48

Mr. Grant Parks
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	As of July 29, 2024, there are 6,075 annual licenses and 2,842 total provisional licenses.	
However, DCC did not ensure that the grant agreements contained measurable benchmarks or metrics. In fact, DCC approved four grantees' grant agreements even though they did not provide goals.	In January 2024, DCC revised the biannual reporting documents to include a requirement that all goals have specific, measurable, time bound outcomes that align with budget line items. As of the February 2024 Biannual Reporting Period, DCC has received updated goals, intended outcomes, and timelines from each of the 17 local jurisdictions through amendments to the original grant agreements or updated responses received via revised biannual reports.	2
The grantees' overall slow pace in spending their grant funds is understandable in some cases because, for example, it can take time to recruit new staff or to execute contracts. Nevertheless, grantees' minimal grant fund expenditures during the program's first year likely resulted in the Grant Program's minimal initial impact.	There are numerous factors that impact timelines and in turn use of funds. This included time to recruit new staff to complete application reviews, execution of contracts to support CEQA efforts, or purchasing of equipment or licensing system software to support jurisdictions in processing provisional licensees at the local level. Lastly, local jurisdictions continued to see provisional licenses being issued through September 2022, further expanding the scope of their work.	

Chapter 3, Condition 2 – DCC Does Not Track the Timeliness of Its Licensing Process		
CSA Observation	DCC Response	
Within Chapter 3, Figure 4: DCC does not track when the applicant provides missing information nor when the scientific review begins, and as a result cannot determine whether DCC or the applicant caused a delay.	DCC's systems can currently track when the administrative review and scientific review starts and closes. The systems also track when deficiencies are responded to (uploads) and the date the Department received the required documentation. The systems do not track automatically (though it can be done manually) how many days it took for the Department to review what was submitted.	
Further, according to a supervisor in DCC's licensing division, DCC does not create or store hard copy files documenting all the relevant steps in the application process for each of the three licensing systems because everything is filed electronically.	DCC has electronic files documenting all relevant steps in the application process for each of the three licensing systems. Records are not "deleted". The way the systems are designed (which mirrors Business and Professions Code 26050.2 (j)) results in a provisional license being "canceled" when an annual license is issued. The relevant records associated with that annual license are retained in the system. In regard to tracking the length of time for processing, the system does not do this, however, the Department is able to manually track the length of time it takes to review and approve the license.	6
DCC environmental program manager explained that because	In April 2023, DCC's Licensing Division began incorporating due dates on all provisional license deficiency notices. The	2

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DCC has not established any deadlines for applicants to provide missing information or unfinished documents, applicants are not pressured to provide required information in a timely manner. She told us that DCC plans to establish deadlines for applicants to provide missing information. However, she also stated that her team prioritizes new retail and distribution license applications and that they work on provisional licenses only when time permits because of lack of time and staff.	date is based on the type and number of deficiencies; it varies from thirty to forty-five days. In 2022, the Licensing Division focused on application reviews to issue new provisional retail and distribution applications due to the June 30th statutory deadlines set in statute (Business and Professions Code 26050.2).

Furthermore, as stated previously, DCC generally agrees with the premises of the following recommendations put forth by CSA and has already commenced implementation of those recommendations that are appropriate and feasible:

Chapter 1, Recommendation #1	
CSA Recommendation	**DCC Response**
To better align its management of grant programs with best practices, by February (2) 2025, DCC should institute a grants management policy. This policy should accomplish the following at a minimum: • Designate the DCC staff member responsible for determining that proposed activities and costs are allowable during the grant review process. • Establish a process to ensure that each element of the policy has been reviewed, such as reviewing costs for allowability. • Establish benchmarks or other criteria in grant agreements for measuring grantee progress toward a grant program's goals. • Specify the preferred method for disbursing grant funds, taking into	DCC agrees with CSA's recommendation. DCC's Administration Division has developed a formal Grant Management Manual and implemented its use. The Grant Management Manual requires that each DCC grant program have an accompanying grant procedural manual. The Grant Management Manual outlines each of the best practices recommended by CSA. The procedural manual for the LJAG program is currently drafted and will be finalized by September 1, 2024.

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account common grant management best practices. • Establish an amendment review process that includes internal and external deadlines to ensure DCC processes amendments in a timelier manner. • Establish procedures for monitoring expenditures and determining their allowability.	

Chapter 1, Recommendation #2	
CSA Recommendation	**DCC Response**
To provide grantees with timely feedback about whether their spending is allowable or whether they will be required to return funds, DCC should immediately begin reviewing grantees' expenditures to determine whether their expenditures are appropriate and begin communicating those determinations to the grantees.	DCC agrees with CSA's recommendation. The Department has incorporated this recommendation into its current procedures by augmenting its budget and expenditure reviews. As of January 2024, the Office of Grant Management began performing a more extensive review of grantee expenditures dating back to the inception of the grant program by using an expenditure review checklist. DCC's review of grantee expenditures involves the reconciliation of grantees' reported expenditures with supporting documentation and the scheduling of individual technical assistance meetings with local jurisdictions to review reporting requirements and questionable or unallowable costs. In addition to conducting reviews of expenditures, DCC has updated its LJAG Program Frequently Asked Questions (FAQs) and its Biannual Reporting Template, the latter of which includes the expenditure documentation checklist, to assist grantees in providing sufficient documentation and information for review. Lastly, DCC has developed procedural documents guiding the payment of the remaining 20% of award funds, the recapture of unspent or unallowable grant funds, and the closeout of grant agreements.

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	DCC will continue to review grantee expenditures throughout the life of the grant agreement.

Chapter 1, Recommendation #3	
CSA Recommendation	**DCC Response**
7 To help ensure that state grant funds and related interest benefit only the Grant Program, DCC should immediately direct all grantees to place any unspent grant funds in interest-bearing accounts, track and report to DCC the interest accrued from those funds and use that accrued interest for the purpose of the Grant Program.	DCC partially agrees with CSA's recommendation. Currently (and at the time of the Budget Act appropriating the funds for the Local Jurisdiction Assistance Grant Program) not all grant advance payments in California are required to be deposited into interest bearing accounts. Without an express statutory directive or a directive within the grant guidelines, the local jurisdiction may exercise their deposit of funds powers pursuant to Government Code section 53630 et seq., which also addresses the treatment of interest, if any. Some legislative acts creating grant programs expressly require deposits into interest-bearing accounts. Government Code section 11019.1 was added by Assembly Bill 156 with an effective date of September 27, 2022, to implement a pilot program to explore possible improvements to the state's existing advance payment practices for state-funded local assistance grants. A report is due to the Legislature on or before January 10, 2025. Therefore, it is possible that future grants will statutorily require advance payments to be deposited into a federally insured, interest-bearing account. The Department of Cannabis Control will consider this recommendation for future grant awards.

Chapter 3, Recommendation #1	
CSA Recommendation	**DCC Response**
To better monitor the timeliness of its license application process, by February 2025, DCC should identify the steps in the license application process, alter its license tracking	DCC partially agrees with CSA's recommendation.

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systems as necessary to track relevant data to that process, and begin analyzing the data to determine how to shorten the average time it takes to issue a license.	DCC is working towards transitioning the three licensing systems into one unified system. The Department has successfully transitioned one of the two systems as of November 2023. A vendor to begin the business process scoping related to transitioning all licensing data into one system has been onboarded and as-is business mapping has begun and will be completed Fall 2024. The Department recognizes the importance of being able to track staff time and efficiency of processing licenses, however, a system consolidation of this scale – inclusive of all of the Department's licenses and compliance data - cannot be completed in six months for numerous reasons including data integrity, security, and procurement timelines. Additionally, a consolidation of this breadth will require resources and regulatory changes. Furthermore it is important to note that in the cannabis licensing framework there are several external dependencies that impact processing time given California's dual licensing framework for commercial cannabis: local authorization, responsiveness of the applicant to meeting all local laws and regulations, meeting the required standards of the California Environmental Act (projects can take anywhere from three months to over twenty-four months to meet CEQA requirements), and meeting all state annual requirements.	8

Lastly, while DCC understands CSA's rationale behind the following recommendation, DCC respectfully disagrees with the recommendation on the grounds that the recommendation does not account for the appropriate use of DCC's discretionary powers.

Other Areas Reviewed, Recommendation #2		
CSA Recommendation	**DCC Response**	
To give grantees sufficient time to spend the grant funds, DCC should immediately reassess whether its March 31, 2025, spending deadline is necessary. If that deadline is not necessary, DCC should change it to the June 30, 2025, deadline established in state law.	DCC disagrees with CSA's recommendation. DCC has determined the March 31, 2025, deadline to be necessary and appropriate. Item 1115-101-0001 of Section 2.00 of the Budget Act of 2021, Provision 6 subdivision (a) specifically provides that:	9

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	The Department of Cannabis Control may recapture funds disbursed pursuant to Provision 3 under the following circumstances: a. *Funds are not expended by the date established by the Department of Cannabis Control.* The statute specifically allows the Department to establish a date by which the funds must be expended, and Provision 8 provides authority to adopt guidelines. Accordingly, the Department included a date by which funds must be expended. Prior to the June 30, 2025, deadline, DCC must work with the jurisdictions to receive close-out reports and final expenditure documentation. Therefore, DCC established the March 31, 2025, date to allow adequate time for the grantees to submit the requested documentation and for DCC to review and reconcile expenditure records and final report goal accomplishments prior to the deadline set in statute. If DCC moved the deadline to June 30, 2025, then the grant program is at risk for not being able to close out the grants in a timely manner.

We look forward to continuing to implement and monitoring these recommendations and will update CSA on the continued development of our LJAG Program. If you have any questions or concerns related to this response, please do not hesitate to contact me at your convenience.

Respectfully,

Nicole Elliott Digitally signed by Nicole Elliott
Date: 2024.08.01 16:08:56 -07'00'

Nicole Elliott
Director

Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE DEPARTMENT OF CANNABIS CONTROL

To provide clarity and perspective, we are commenting on DCC's response to our audit. The numbers below correspond with the numbers we have placed in the margin of its response.

The references to our report that DCC includes in its response are based on its review of the draft report. As part of our quality control process, our standard practice is to provide agencies five working days to review and comment on a draft copy of the report. During that time, we made minor edits to the report text that do not affect our report's conclusions or recommendations. ①

DCC indicates in its response that it has taken corrective action to address our findings and recommendations related to its administration of the Grant Program. We look forward to reviewing DCC's 60-day response to the audit and any evidence DCC provides at that time to support its efforts to fully implement the recommendations. ②

We disagree with DCC's belief that the Grant Program's purpose is broader than aiding local jurisdictions to assist cannabis businesses transition from provisional licenses to annual state licenses. As we describe on page 5, the intent of the Grant Program is to provide assistance to certain local government jurisdictions needing assistance in transitioning provisional state license holders to annual state licenses. The Grant Program's purpose does not include assisting cannabis businesses to maintain annual state licenses they already have. However, as we note on page 9, the county of Humboldt used its grant funds for both provisional license holders as well as cannabis businesses that already held an annual state license. Further, Humboldt acknowledged to us that its goal for using these funds was to ensure environmental protection and to address roadblocks to obtaining local permits. Although that goal may benefit the county of Humboldt and its residents, providing more than $3 million in sub-grants to 50 cannabis businesses that have already obtained an annual state license does not align with the purpose for which the Legislature appropriated these funds. ③

Although DCC believes that it was justified in advancing 80 percent of the grant funds to local jurisdictions, we stand by our conclusion on page 10 that this decision placed those funds at risk. In addition, as we address on page 12, DCC has not conducted sufficient monitoring of grantees, which may in fact have contributed to some local jurisdictions' improper use of the grant funds, as we explain in Chapter 2. Moreover, many grantees have been slow to spend their funds. As Table 2 on page 14 shows, the majority of the grantees made minimal expenditures in the first year of the Grant Program, spending just $2 million of the $95 million that DCC awarded, or only 2 percent. This situation has resulted in grantees holding significant amounts of funds, without any direction from DCC on whether they should place the funds into interest-bearing accounts or what they are to do with accumulated interest, as we describe on pages 19 and 20. ④

5 We did not validate DCC's assertions related to the number of provisional licenses it has transitioned during the last three fiscal years because our review of license data focused on license statuses only in calendar years 2021 and 2022. However, DCC's response indicates that a significant number of provisional licenses—more than 2,800—still need to be transitioned to annual state licenses as of August 2024. This is the first of three annual performance audits that the Budget Act requires us to perform. As part of conducting the two additional audits, we will continue to evaluate DCC's progress towards transitioning more provisional licenses to annual state licenses.

6 DCC's response addresses text on page 33 where we state that transitioning a provisional retail license to an annual state license in the retail licensing system results in DCC staff no longer having access to the original dates an application entered certain phases. We clarified the text to state that the relevant information is no longer available for Grant Program staff to access in the system.

7 In consideration of DCC's response, we reexamined our recommendation that DCC should immediately direct all grantees to place any unspent grant funds in interest-bearing accounts. We agree that DCC does not have the authority to direct the grantees to place any unspent grant funds in interest-bearing accounts. However, DCC does have authority to recommend that grantees do so—a practice that is both allowable under state law and a prudent, best practice. We modified our recommendation to align with DCC's authority.

The provisions DCC noted in its response regarding the use of accrued interest on grant funds are incorrect. State law explicitly limits the use of grant funds to the Grant Program's purpose. Accordingly, a local jurisdiction is restricted from using the grant funds for a purpose not authorized by the Grant Program. California case law also establishes that interest generally must be used for the same purpose as the principal from which it was earned, meaning that grantees must use the accrued interest on grant funds for the purpose of the Grant Program. The statutes DCC cites in its response do not abrogate California case law. Therefore, we stand by our recommendation on page 21 that DCC direct all grantees to track and report to DCC any interest accrued from those funds. However, we modified the recommendation slightly to state that DCC should clarify that the accrued interest be used only for the purpose of the Grant Program.

8 Although we had numerous conversations with DCC, including the exit conference with it in May 2024, DCC did not communicate that it cannot fully implement our recommendation within the six-month time frame and is now asserting that it believes more time is needed to transition its three systems into a unified system. However, our recommendation on page 35 was that it alter the three existing systems as necessary to track relevant data in the application process. We believe this action does not require DCC to consolidate its three systems and that DCC can substantially complete these alterations within the six-month time frame we propose.

9 We acknowledge on page 37 that DCC must complete certain procedural requirements before redistributing any recaptured funds. However, in establishing a spending deadline of March 31, 2025, DCC has shortened the time frame for grantees

to spend these funds by three months. Given the short lifetime of the Grant Program and the fact that grantees have been slow to spend the funds, DCC should consider changing its expenditure deadline to match the deadline established in state law. Moreover, if there are unspent funds existing at June 30, 2025, state law allows those funds to be encumbered to pay for any expenditures that grantees have committed to make but had not paid as of that date, which is a common practice with state funds. Therefore, this provision does allow adequate time for grantees to submit documentation and for DCC to review and reconcile grantees' expenditure records.