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# Implementation of State Auditor's Recommendations

**Audits Released in January 2001  
Through January 2003**

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

February 2003  
Report No. 2003-406

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# INTRODUCTION

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This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2001 through January 2003. The purpose of this report is to identify what actions, if any, these auditees have taken in response to our findings and recommendations. We have placed this symbol ➤ in the left-hand margin of the auditee action to identify areas of concern or issues that we believe the auditee has not adequately addressed. In the Appendix, we have compiled the recommendations we specifically direct to the Legislature. We have also included an index referring to each entity responding to audits included in this report.

For this report, we have relied upon periodic written responses prepared by auditees to determine whether corrective action has been taken. The Bureau of State Audits' (BSA) policy requests that auditees provide a written response to the audit findings and recommendations before the audit report is initially issued publicly. As a follow-up, we request the auditee to respond at least three times subsequently: at 60 days, 6 months, and 1 year after the public release of the audit report. We may at times request follow-up beyond 1 year or have initiated a follow-up audit if deemed necessary.

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

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of January 8, 2003.

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# CENTRAL BASIN MUNICIPAL WATER DISTRICT

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## ***Its Poorly Planned Recycled-Water Project Has Burdened Taxpayers but May Be Moving Toward Self-Sufficiency***

REPORT NUMBER 2000-115, APRIL 2001

Central Basin Municipal Water District's response as of  
September 2002

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

*The Central Basin Municipal Water District (district) poorly planned its recycled-water project (project) because it:*

- ☒ *Overstated the project's potential for self-sufficiency by ignoring lower projections when estimating future revenue.*
- ☒ *Failed to gain firm purchasing commitments before building the project.*

*As a result, the district:*

- ☒ *Still relies on \$3 million in annual standby charges.*
- ☒ *Currently distributes water costing \$1,395 per acre-foot compared to \$431 per acre-foot for imported water.*

*Recent decisions to halt project expansion and seek more customers suggest the district is trying to move toward self-sufficiency.*

*Nevertheless, even if it meets sales goals, the district will suffer revenue shortfalls of \$1.8 million per year without standby charges.*

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The Joint Legislative Audit Committee requested that we review the Central Basin Municipal Water District's (district) recycled-water project (project) to determine whether the district undertook proper planning, met project goals, provided a cost-effective source of water, and fairly served its taxpayers. We found that:

### **Finding #1: The district inadequately planned its project.**

In developing revenue projections for its project in 1991, the district assumed rapidly increasing rates for alternative, imported water from the Metropolitan Water District of Southern California (Metropolitan), but ignored other projections forecasting much lower imported water rates. The district only presented taxpayers with a highly optimistic set of forecasts when making a case for establishing a standby charge that it indicated would last for three years. In planning the project, the district also ignored the State Water Resources Control Board's advice that it gain firm customer commitments before building the project. More than nine years later, the district still relies on \$3 million in annual standby charges to support the project.

We recommended that the district reject expansions to the project that do not improve its cost-effectiveness relative to alternative water sources and that it execute binding agreements with potential customers for at least 50 percent of expected water deliveries before undertaking large capital projects.

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

The district told us it currently evaluates the cost-effectiveness of proposed project expansions, and will not recommend a project expansion to the board if the analysis results in the

project not being cost-effective. In July 2002, the City of Vernon (Vernon) signed an agreement with the district to buy up to 1,500 acre-feet of recycled water per year in anticipation of Vernon's building a pipeline extension for its proposed electrical generation facility. The district also signed a memorandum of understanding (MOU) with Vernon to explore the use of recycled water by businesses and industries in Vernon. As part of this MOU the district will pursue letters of commitment from interested recycled water customers.

**Finding #2: Low sales and recycled-water rates have caused the project to continue to rely on taxpayers.**

More than nine years after inception, the project is only operating at 43 percent of its initially projected capacity. In addition, although the district originally predicted that it would charge customers a rate equal to 90 percent of the Metropolitan's rate for imported water, it barely increased its recycled-water rates despite substantially higher Metropolitan rates. If the district were to increase its rate to 80 percent of the Metropolitan rate, it could increase its annual revenues by \$327,000.

We recommended that the district continue to study the feasibility of raising its recycled-water rates to increase revenues and reduce reliance on general taxpayers.

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

The district raised its recycled water rates by \$10 per acre-foot on July 1, 2001, and by another \$6 per acre-foot on July 1, 2002. An August 2002 study found that the district's recycled water rates are currently between 49 percent and 62 percent of those for imported water. The consultant recommended that the district gradually increase its recycled water rates until they approach 70 percent to 80 percent of that charged for imported water, but not at the cost of slowing expansion of the recycled water program.

**Finding #3: Current decisions may improve the project's finances, but the standby charge will still be needed.**

The district recently halted plans for expansion of the project when its economic analysis revealed that the expansion would not be cost-effective. Current efforts to sell water to the neighboring Upper San Gabriel Valley Municipal Water

District (San Gabriel) and to district customers using the existing system could, however, reduce cost per acre-foot from \$1,395 to as little as \$684. Nevertheless, costs per acre-foot would still exceed the \$431 per acre-foot cost of imported water, and annual revenue shortfalls would amount to \$1.8 million, without standby charges. In addition, sales to San Gabriel would include an “out-of-district” charge meant to compensate for the fact that San Gabriel does not contribute to the district’s standby charge. The district has not, however, analyzed the out-of-district charge to determine if it would be adequate at \$20 per acre-foot. Finally, the district will need to make adequate provision for replacement of its recycled-water system as it ages. While the district originally stated that it would set aside \$3.5 million for system replacement by fiscal year 2000–01, it had only reserved about \$1.5 million for this purpose by April 2001.

We recommended that the district prepare an analysis to support the out-of-district charge for San Gabriel and establish sufficient reserves to maintain the recycled-water system.

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

An August 2002 cost-of-service study found that the district’s additional charge of \$20 per acre-foot for customers outside of its district reflects higher unit costs for these customers, calculated on a cost-of-service basis. In addition, the district’s board adopted a revised reserve policy outlining designated fund targets. Staff recommended using 10 percent of the projected capital asset replacement cost to determine the target level for the Capital Asset Replacement Fund and 2 percent for the Emergency Repairs Fund.





# TECHNOLOGY, TRADE AND COMMERCE AGENCY

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## ***Its Strategic Planning Is Fragmented and Incomplete, and Its International Division Needs to Better Coordinate With Other Entities, but Its Economic Development Division Customers Generally Are Satisfied***

REPORT NUMBER 2001-115, DECEMBER 2001

Technology, Trade and Commerce Agency's response as of December 2002

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

*Our review of the Technology, Trade and Commerce Agency (agency) found that:*

*The agency has no agency-wide strategic plan, and many program plans continue to lack elements of strategic planning including:*

- ☒ *Goals for all significant aspects of program missions.*
- ☒ *Targets for significant goals or targets that challenge performance.*
- ☒ *A comparison of results to targets in external reports.*

*Further, external coordination of export services is limited for the agency's International Trade and Investment Division, but recent activities indicate a renewed focus on this issue.*

*Finally, programs in the agency's Economic Development Division generally satisfy their customers but lack formal processes to measure customer satisfaction.*

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The Joint Legislative Audit Committee (committee) requested that we review the Technology, Trade and Commerce Agency's (agency) progress in implementing a strategic plan, mission, goals, and performance measures, and that we examine the effect of state policy guidance provided by the World Trade Commission. The committee also requested that we evaluate the agency's coordination activities with external entities involved in export promotion and foreign investment, and the responsiveness of the agency's Economic Development Division to its customers. We found that:

### **Finding #1: The agency does not have an agency-wide strategic plan, and program plans continue to lack elements of strategic planning.**

Despite starting two agency-wide strategic planning processes since 1996, the agency still does not have an agency-wide strategic plan. It has reverted to using individual program plans, which are often incomplete and vary widely because the agency has not set standards for planning. For example, many program plans do not include goals for all significant aspects of their mission or vision statements or for outcomes included in external reports. In some cases, these plans do not include any outcomes goals, thus lacking a focus on the benefits that their programs are trying to achieve. In addition, some plans do not include quantified targets for their goals, and some do not include targets that challenge performance. Moreover, internal and external reports on program accomplishments rarely compare targets that do exist with actual results, reducing accountability

within the agency and to stakeholders such as the Legislature. Finally, no programs we reviewed developed plans covering five or more years, and many programs did not consider opportunities or threats from their external environment in establishing their plans, diminishing their ability to position themselves for maximum effectiveness. By de-emphasizing strategic planning, the agency misses the benefits of a broad, outcome-oriented approach, which is vital to integrating diverse programs, allocating resources to efforts that best advance overall goals, and demonstrating the value of the agency's activities.

We recommended that the agency develop an agency-wide strategic plan covering at least five years and include basic strategic planning elements in its process. These elements include goals and targets for all significant aspects of its mission and vision and for significant accomplishments noted in its external reports, outcome goals that focus efforts on results, targets that are challenging in light of past performance and expected economic assumptions, comparisons of results with targets in internal and external reports, and scans of the environment to identify opportunities and threats that could significantly affect goals. We also recommended that the agency report to the Legislature biennially on its progress in implementing a strategic approach to planning.

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

In September 2002 the agency completed an analysis of its strengths, weaknesses, opportunities, and threats, and in December 2002 it published an agency-wide strategic plan, including a mission statement, goals, objectives, and outcomes. Although the agency's strategic plan states that it covers five years, no goals, objectives, or outcomes are tied to a particular timeframe. In addition, the strategic plan does not include quantified targets for outcomes, but it does include a strategy to specify targeted outcomes and intended consequences for each program. In conjunction with the agency-wide strategic plan, the agency has completed one-year business plans for its programs. These plans generally follow a standard format that includes basic strategic planning elements. Nevertheless, some program plans still do not have outcome goals or do not have quantified targets for outcome goals. Finally, the agency did not indicate that it planned to report to the Legislature biennially on its progress in implementing a strategic approach to planning. However, it planned to send its strategic plan, including updates, to the Legislature each year.

**Finding #2: Vacancies in the agency's International Trade and Investment Division (International Division) weakened planning and operations at the foreign offices and World Trade Commission (commission).**

Lengthy vacancies for appointed positions at some of the International Division units weakened planning and operations. Vacancies at foreign offices, where all positions are appointed, resulted in a lack of plans and focus during two recent years. For instance, almost half of the positions at the Mexico office were vacant for about a year or more, causing the office to function at a minimal level. A review of appointments made to all foreign offices since January 1999 showed that, on average, positions were vacant 10.5 months with the agency taking nearly 9 months to submit nominations. Similarly, the commission lacked a chairperson and did not meet between October 1998 and March 2000. Subsequently, the commission has provided little policy direction. It is now considering initiating its first study since 1998.

We recommended that the agency give high priority to nominating persons to appointed management positions in the International Division and that it nominate persons to appointed staff positions where necessary for program continuity even if managers are not yet appointed. We recommended that the commission consider implementing procedures so it can continue to advise the agency even if a chairperson is not appointed.



***Agency Action: None.***

The agency did not indicate that it would change its processes for nominating persons to positions in its International Division. It, however, said that it would continue to give the highest priority to filling management and staff appointed positions. When it last reported on this recommendation in June 2002, the agency indicated that between December 2001 and May 2002, there were no new vacancies or hires in the Foreign Trade and Investment Office.

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

The agency said that the commission's bylaws were amended in May 2002 to allow the vice-chair to call meetings of the commission.

**Finding #3: Some data on program benefits and outcomes may be unreliable or inaccurate.**

The agency's programs generally do not verify data that may be considered inherently unreliable, such as data from clients who may have an incentive to exaggerate results. For example, the Small Business Loan Guarantee Program relies on estimates provided by borrowers on the number of jobs they expect to create or retain through guaranteed loans. These clients may perceive an incentive to overestimate these outcomes in hopes of securing loan guarantees. Where data is not inherently unreliable, the agency may still report inaccurate results. For example, the agency's Office of Foreign Investment receives data from its clients on the number of jobs they expect to create, but it does not have a process for systematically rechecking this data at the completion of a project, when actual figures should be available. When programs base the results in their performance reports on such data, they risk misstating the true benefits of their programs.

We recommended that the agency verify some of the inherently less reliable, client-supplied information on a sample basis. We also recommended that the agency ensure the accuracy of its data, performing follow-up on client estimates as needed.



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

The agency indicated that the Economic Development Division developed methods and schedules to conduct client surveys to ensure the reliability of data. When it last reported on this issue in June 2002, the agency stated it planned to work with the Employment Development Department to verify client-supplied information on a sample basis. The agency did not address what offices outside its Economic Development Division, such as the Office of Foreign Investment, plan to do in response to our recommendation.

**Finding #4: The International Division's efforts to coordinate its export-related services have been limited.**

The International Division has coordinated its export-related services with other entities working in the international community to only a limited extent while it appears to have adequately coordinated its services to promote foreign investment. With

only limited coordination, the International Division cannot ensure that it has fully leveraged the State's resources and addressed gaps and redundancies in the delivery of services. For example, its Office of Export Development generally uses its own resources to match potential foreign buyers with California exporters, sending trade leads from foreign buyers to other entities only if it cannot find an appropriate exporter match. In addition, the International Division does not hold regular, broad-based coordination meetings with other entities and has experienced problems coordinating with the California Department of Food and Agriculture and the California Energy Commission. Acknowledging it needs to put more effort into coordination, the International Division has begun some initiatives to coordinate export services. Although they are steps in the right direction, their effectiveness remains to be seen, and further initiatives are needed.

We recommended that the International Division increase its coordination efforts, including holding regular meetings with other entities to discuss goals and operations, analyzing the service delivery system to reduce service gaps and redundancies, establishing agreements that spell out its roles and interactions with other entities, and discussing the trade lead system with other entities.

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

The agency said that it conducted and has scheduled meetings with key partners to discuss goals and operations. In addition, activities in the Office of Export Development's 2002-03 business plan include implementing an agreement to coordinate activities between the office and the 17 Centers for International Trade Development, dissemination of trade leads that do not fall within the office's core competencies, and including other entities working in the international arena as participating partners in the office's events. The agency also said that it has been negotiating roles and responsibilities with other state agencies although it did not indicate that it had entered into formal agreements with them. The agency's strategic plan calls for working with existing partners to identify similar programs and services and achieve a more coordinated system of service provision and referral.

**Finding #5: Possible redundancy in the existing service delivery structure merits further study.**

The current service delivery structure seems to perpetuate redundancies. Under the existing structure, the International Division promotes its services, generates trade leads, matches trade leads with exporters, organizes trade missions and shows, and guarantees loans to exporters. Various other entities provide similar types of services, and duplication of services appears to occur at the local, state, and federal levels. The question of which entities should provide particular services is, however, complicated. Although some entities may provide similar services, their overall mission, focus, and policy on charging for services may be different. In addition, entities represent different levels of government, and some are not even a part of government. Despite these complications, the issue of possible redundancies warrants further attention, with an eye toward better leveraging each party's efforts.

We recommended that the Legislature consider commissioning an independent statewide study of the existing delivery system for export services to determine the best division of work and resources among the various entities in the international arena.

***Legislative Action: Legislation vetoed.***

In August 2002, the Legislature passed Assembly Bill 627 requiring the California State University to conduct a two-year study on existing delivery systems for export services for businesses in California, and to recommend the most appropriate and efficient division of work and resources among both public and private sector agencies and organizations, including the Technology, Trade and Commerce Agency. In vetoing this legislation, the governor said that while such a study might provide useful information, he could not support expenditures for the study at this time, given the State's \$24 billion deficit.

**Finding #6: The agency's Economic Development Division generally provides good customer service, but it could benefit from formal processes to measure customer satisfaction.**

Although programs lack formal feedback mechanisms and targets for customer satisfaction, our survey of a sample of customers for seven Economic Development Division programs found that customer service rankings for five programs

were above average. Nevertheless, the survey results indicated room for improvement, with some customers noting specific concerns. Customers' suggestions included improving the timeliness of information, being more proactive in obtaining feedback, and improving the transition process during changes in administration. By using formal methods, such as goals and targets for customer satisfaction and customer satisfaction surveys, programs would be able to measure their performance and more reliably determine customers' unmet needs and expectations.

We recommended that the Economic Development Division improve customer satisfaction by developing goals and targets for customer satisfaction, periodically surveying customers to gauge the quality of customers service, evaluating performance by comparing survey results with targets, and changing services as needed.

***Agency Action: Corrective action taken.***

The Economic Development Division revised work plans to include survey methods and a schedule for gauging the level of customer satisfaction. It also revised its plans to incorporate methods for comparing results to targets in order to evaluate performance and change services as needed.

**Finding #7: The Small Business Loan Guarantee Program needs to work out differences with the financial development corporations.**

Although customers for most of the Economic Development Division programs we reviewed were satisfied, those of the Small Business Loan Guarantee Program were not. These customers, financial development corporations, gave the program a score of only 2.2 on a 5-point scale. The financial development corporations' concerns included inconsistent and slow technical service, lack of continuity during the latest transition in state administrations, lack of a statewide marketing effort for the program, and no efforts to gain their feedback. Some also complained that the program did not do enough to promote increased state funding.

We recommended that the Small Business Loan Guarantee Program work with the financial development corporations to discuss their concerns and determine what actions it should take to resolve them.



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

The agency met with the financial development corporations in February 2002 to address funding concerns. In addition, the 2002–03 business plan for the Office of Small Business calls for it to meet with the financial development corporations every four months and to conduct a satisfaction survey of financial development corporations.

# THE STATE'S REAL PROPERTY ASSETS

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## ***The State Has Identified Surplus Real Property, but Some of Its Property Management Processes Are Ineffective***

REPORT NUMBER 2000-117, JANUARY 2001

Department of General Services' and Department of Transportation's responses as of January 2002

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

*Our review of the State's management of its real property assets reveals:*

- ☑ *Although there are numerous properties in the State's surplus property inventories, many are not available for disposal and the disposal process is slow.*
  - ☑ *The State's approach for identifying surplus property remains flawed.*
  - ☑ *State agencies' inventory systems do not provide effective property management tools or reliable reports.*
  - ☑ *General Services can improve its management of the State's office space, including space leased out for child care facilities.*
- 

In requesting this audit, the Legislature expressed an interest in the availability of surplus state properties in high-cost counties for public use, such as housing, parks, or open space. Therefore, our audit focuses on how much surplus or underused state-owned real property exists in 15 of the State's counties where the cost of real estate is relatively high and housing is relatively scarce and whether agencies are adequately managing their property. Specifically, we assessed the property management procedures for the two agencies primarily responsible for disposing of the State's surplus property: the Department of General Services (General Services) and the Department of Transportation (Caltrans). We also reviewed the property management practices of eight other agencies with large landholdings in high-cost counties. We found that the State has many surplus properties in high-cost areas. However, the State still does not use effective systems or processes to manage its real property despite the State's efforts in response to several past studies regarding its property management.

**Finding #1: General Services has 27 properties located in 15 high-cost counties in its surplus property inventory; however, few of these properties are currently available for sale, and the disposal process can take years.**

General Services has contributed to delays in the disposal of surplus properties because it has not always maintained adequate staffing in its Surplus Sales Unit (Surplus Sales), which is the unit primarily responsible for selling surplus property. In addition, Surplus Sales has not always promptly assigned surplus properties to staff for disposal. When surplus properties sit idle, the State does not benefit from funds it would receive by selling or leasing these properties, and it may incur unnecessary maintenance costs. Further, until leased or sold, these properties are not available for other purposes, such as housing.

To help dispose of the State's surplus real estate in a timely manner, we recommended that General Services fill the vacant positions in its unit responsible for selling, leasing, or exchanging surplus properties. We also recommended that General Services promptly assign to staff the properties that require disposal.

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

General Services stated that current operating practices ensure that prompt actions are taken to fill vacancies in the unit. Although the unit currently has one vacancy, the position is being advertised and will be filled as soon as possible. General Services stated that it also redirects staff, when necessary, to ensure adequate coverage in the unit. Finally, to ensure prompt processing, properties are assigned to staff immediately after the surplus bill is signed into law rather than waiting until the law takes effect on January 1.

**Finding #2: Caltrans' Excess Land Management System (ELMS), which serves as Caltrans' inventory of surplus properties, lists 1,928 properties in the 15 high-cost counties; however, the ELMS is incomplete.**

The ELMS also overstates the number of properties actually available for sale. Moreover, after Caltrans identifies a property as surplus, years may pass before the property is available for disposal. When delays occur in the sales of surplus properties, Caltrans, which retains the proceeds from such sales, does not have these funds available to address other needs of the department.

We recommended that Caltrans take the necessary steps to make certain that it properly accounts for and disposes of surplus property as rapidly as possible. These steps should include making sure that Caltrans staff promptly includes and correctly categorizes all surplus property in ELMS. In addition, Caltrans should develop methods to ensure that it completes all aspects of highway projects, including the prompt disposal of surplus property.

***Caltrans' Action: Partial corrective action taken.***

Caltrans stated that it continues to work on completing a full reconciliation of ELMS and its Right of Way Property Management System (RWPS), and that it has made significant progress in correcting errors and omissions in ELMS. Caltrans also reported several actions it has taken to ensure prompt disposal of properties. These actions include: ensuring

districts' excess lands sections are appropriately staffed, using retired annuitants when necessary, pursuing a consultant contract for surveying services, and issuing guidelines for local agency involvement in right of way acquisition and project delivery.

**Finding #3: The State lacks oversight of property management activities designed to ensure landowning State agencies are diligently reviewing their property holdings and identifying property that is surplus to their program needs.**

Although these state agencies are responsible for conducting annual reviews of their property holdings to identify surplus property, they generally have not developed and implemented adequate procedures for doing so. Also, few incentives exist for most agencies to actively identify and dispose of surplus property because the proceeds from most property sales do not benefit the selling agency but are deposited in the State's General Fund. The State could improve its real estate management by implementing practices used by other governmental entities such as using an independent body to review property retention processes and criteria and to arbitrate property retention decisions. When surplus properties remain unidentified, the State does not benefit from funds it would receive by selling or leasing these properties, and it may incur unnecessary maintenance costs. Also, until leased or sold, these properties are not available for other purposes, such as housing, parks, or open space.

To provide consistency and quality control over the review of the State's real property holdings, we recommended that the Legislature consider empowering an existing agency or creating a new commission or authority with the following responsibilities:

- Establishing standards for the frequency and content of property reviews and land management plans.
- Monitoring agencies' compliance with the standards.
- Scrutinizing agencies' property retention decisions.

Alternatively, this entity could be responsible for periodically conducting reviews of the State's real property and making recommendations to the Legislature regarding the property's retention or disposal.

If the Legislature does not wish to establish such an oversight entity, it should consider replacing the current requirement for annual property reviews with a requirement for less frequent but more comprehensive reviews.

The Legislature should also consider providing incentives to state agencies to encourage them to identify surplus and underused property so that they free the real estate for better uses. Such incentives could include allowing agencies to retain the proceeds from the disposition of surplus properties for use either in funding current or planned capital outlays for new property or in improving and modernizing existing facilities when the need exists. Additionally, when agencies need to acquire or improve facilities, incentives for disposing of excess property could include guaranteeing agencies the market value for the surplus property they sell or transfer.

***Legislative Action: Unknown.***

We are not aware of any legislative action concerning this recommendation.

**Finding #4: Caltrans has not performed adequate reviews of its property holdings.**

Unreliable inventory reports and weaknesses in its retention review guidelines hinder Caltrans' efforts to conduct property-retention reviews. Consequently, Caltrans cannot be certain that it has identified all surplus property, the disposal of which would generate funds that Caltrans could use to meet its other needs.

To ensure that it adequately reviews its real property holdings and identifies surplus properties, we recommended that Caltrans management improve its support for the retention reviews conducted by its districts. We recommended that Caltrans seek to improve the reviews in the following ways:

- Make certain that the various units at district offices adequately participate in and work together to administer effectively the annual reviews of real property retention.
- Ensure that district offices follow the retention-review guidelines and maintain asset managers to provide year-round coordination of the management of surplus property and to improve the quality of annual retention review efforts.

- Revise the retention-review guidelines so that they include the following elements:
  - ♦ Specific criteria for districts to evaluate the buildings and facilities listed in the Asset Management Inventory.
  - ♦ Procedures for ensuring that the ongoing monitoring of surplus property withheld from disposal is sufficient and appropriate.
  - ♦ Steps for reviewing noninventory property to ensure that the department needs the property for future highway projects.

***Caltrans' Action: Partial corrective action taken.***

Caltrans expected to deliver by March 15, 2002, a revised Deputy Directive (directive), which comprehensively addresses the department's facility planning and surplus property management practices. Because of a five and a half month delay in issuing this directive, the Division of Business, Facilities, Asset Management, and Security independently completed its business plan in September 2001. The department's efforts to revise its Real Property Retention Review (RPRR) guidelines have also been delayed and it expected to complete the comprehensive revisions to the RPRR concurrently with the new directive by March 15, 2002. Finally, the department reported that it revised its RPRR to include minimum review frequencies for properties conditionally retained or for which disposal is recommended, a review of noninventory properties, and a preliminary review of properties available for sale.

**Finding #5: The Statewide Property Inventory (inventory) is not yet an effective property management tool because reporting agencies do not cooperate with General Services to ensure that the inventory includes all property owned by the State. In addition, the inventory does not list required property characteristics and property use information.**

We recommended that General Services take the necessary actions to ensure that the inventory contains the information it requires to serve as the statewide property management tool intended by legislation. To accomplish this task, General Services should consider the following steps:

- Working with state agencies to identify the property characteristics the inventory must contain to serve as an effective property management tool and seek changes to the law if necessary.
- Developing changes to methods for operating the inventory system to promote efficiency. For example, new methods could give agencies the ability to enter required property information into the system and to verify the accuracy of the inventory through real-time access to the inventory's data.
- Cooperating with land-owning state agencies to provide standard property identification elements that will facilitate the reconciliation of the inventory systems maintained by the agencies.
- Seeking to change the funding mechanism for the inventory to eliminate the current disincentive for state agencies to provide information to the system.

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

General Services stated that in April 2001, it sent a memorandum to all state agencies asking them to identify any additional information that they would like to see included in the inventory. However, General Services did not provide details on the results from its request. General Services reported that it communicated with agencies on July 30, 2001, regarding how they can cross-reference with their own property identification numbering schemes for reconciliation purposes. General Services also stated that on July 20, 2001, it updated its intranet Web site to allow users to run a number of inventory reports within specified parameters. However, General Services has not deployed inventory information to the internet because of safety and security concerns. In addition, General Services has begun the process of upgrading the inventory to allow state agencies to have data entry capabilities. The first of three stages to upgrade the inventory involves software upgrades to improve operating efficiency. The proposed completion date for stage one is July 2002. General Services did not indicate when it would complete the final two stages, but reported that it would complete each stage when funding becomes available. Finally, General Services determined that there is no fair or practical alternative to the current method for funding the inventory.

**Finding #6: General Services lacks a complete central record of unused or underused property to assist in monitoring the department's progress in selling or enhancing the use of those properties.**

Insufficient mechanisms for monitoring excess state-owned property can result in oversights and unnecessary delays in disposing of this property and can make it difficult or impossible to measure and assess General Services' performance in carrying out the disposition of surplus property.

We recommended that General Services implement its plan to include in its surplus property database all unused or underused property assigned to its Surplus Sales and the Asset Planning and Enhancement Branch and update the surplus property database monthly to assist in monitoring its progress in selling surplus property or enhancing its use.

***General Services' Action: Pending.***

The management of Surplus Sales and the Asset Planning and Enhancement Branch is acting to improve the accuracy and completeness of the surplus property database. General Services expected to complete these improvements by March 1, 2002.

**Finding #7: General Services did not promptly submit its most recent surplus property report to the Legislature, and the report does not provide detailed information about delays in selling several properties.**

The document also does not identify deficiencies in the State's system for identifying and disposing of surplus property or highlight the issues causing lengthy delays in disposing of excess properties and thus misses opportunities to bring these matters to the attention of policy makers. If they had more detailed information regarding these issues, the policy makers might be able to identify opportunities for legislative intervention that could hasten the disposal process.

To improve the value of reports to the Legislature regarding its surplus property inventory, we recommended that General Services submit these reports promptly and consider including additional detailed information on the status of surplus property. In these reports, General Services should also describe the



weaknesses in the State's real property systems and include suggestions to improve the State's ability to identify and dispose of surplus property.

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

General Services agreed to submit its report on surplus property to the Legislature in a more timely manner. General Services stated that it would submit this year's report to executive management by February 2002, but did not indicate when it would submit the report to the Legislature. General Services also stated that the report now includes more detailed information on the status of surplus property. However, it did not address whether the report contains information related to program weaknesses and suggestions for improvement.

**Finding #8: Caltrans does not maintain complete, current databases on real property. Consequently, the databases do not provide sufficient information to aid Caltrans districts in managing their real property.**

In addition, because Caltrans bases its real property reports, including reports to the Legislature and General Services, on information in these databases, the reports do not provide complete, current, or accurate data. Finally, Caltrans does not always produce the annual reports it is required to submit to General Services. Therefore, any decisions or conclusion reached by users of available inventory reports might be based on obsolete information.

To make certain it has reliable information available to manage its real property holdings, we recommended that Caltrans take the necessary steps to correct the information in its real property databases. In addition, until existing reporting requirements are rescinded, Caltrans should take the necessary steps to ensure that it provides accurate, timely annual reports on the status of its real property holdings.

***Caltrans' Action: Partial corrective action taken.***

As mentioned earlier, Caltrans continues to work on completing a full reconciliation of its ELMS and RWPS. Caltrans also stated that it made significant progress in correcting errors and omissions in ELMS. Further, Caltrans reported that it delivered an accurate and timely report with the status of its real property holdings to General Services on

June 29, 2001, and that its development of an Asset Management System is on schedule for implementation by July 2002.

**Finding #9: General Services has not fulfilled all of its obligations to administer a state program to provide space for child care facilities in state-owned buildings.**

General Services does not always enforce the requirements of the program, such as executing lease agreements and collecting rent for building space occupied by child care providers. In addition to losing revenue by not collecting rent, General Services may be exposing the State to unnecessary liability because it has not always executed required building space leases.

To ensure that it complies with state laws governing child care facilities in state-owned buildings, we recommended that General Services take the following necessary steps to make certain it fulfills its oversight responsibilities:

- Improving its administrative controls over leases for child care facilities to ensure that required leases are in place and that nonprofit corporations established by employees to provide child care facilities meet all the terms and conditions of the leases, such as the nonprofits' making agreed-upon payments for the leased spaces.
- Developing and implementing a system to communicate among General Services' relevant units, such as those involved in building design, child care facility review, leasing, and accounting, to ensure that all affected units are aware of child care facilities under General Services' jurisdiction.
- Conducting the required initial reviews to determine whether state employees need child care facilities and, after the facilities have operated for five years, comparing state employees' continuing need for the facility to the State's need for additional office space.

In addition, General Services should make sure that it meets the requirements of the law when determining rents for employees' nonprofit corporations that seek to establish child care facilities in state-owned buildings and when enforcing the terms of lease agreements or seek to change the law's requirements.

***General Services' Action: Pending.***

General Services completed an initial review to identify actions needed to ensure fully operational and viable child care facilities. However, the review raised concerns about the viability of these centers statewide. As a result, General Services chartered another team to develop an action plan and leasing policy that will assure the viability of child care centers in state-owned office buildings. This action plan was completed on December 19, 2001.

The action plan results and recommendations are being considered by executive management. General Services expected the management review to be complete by April 1, 2002.

With regard to assessing the initial and continuing need for child care facilities, General Services stated that its existing policies and practices provide for the conduct of initial child care need studies as required by statute.

Finally, General Services stated that the action plan the charter team developed includes a recommendation related to charging rent to child care facilities. General Services provided its assurance that any rental policies it implements will fully comply with state statutes.

**Finding #10: General Services does not conduct regional studies of office space occupied by state agencies and does not prepare plans to accommodate the State's office space needs as often as the department's procedures require. As a result, General Services cannot be sure that it is adequately managing the State's office space.**

We recommended that General Services perform planned regional office space studies to ensure that it provides an adequate strategy for consolidating the State's office space.

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

General Services stated that several plans are complete or underway. General Services also affirmed its goal to complete regional plans within its established guidelines and stated that staff is tasked to create or update plans as operating priorities allow.

# STATE BAR OF CALIFORNIA

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## ***It Has Improved Its Disciplinary Process, Stewardship of Members' Fees, and Administrative Practices, but Its Cost Recovery and Controls Over Expenses Need Strengthening***

REPORT NUMBER 99030, APRIL 2001

State Bar of California's response as of April 2002

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

*In rebounding from its virtual shutdown, the State Bar of California (State Bar) has made the following improvements:*

- ☒ *Developed a complaint prioritization system that allows staff to address the most serious disciplinary cases first.*
- ☒ *Increased the amounts it charges disciplined attorneys.*
- ☒ *Taken steps to ensure that its mandatory membership fees are reasonable and not used to support voluntary programs.*
- ☒ *Improved controls over contracting.*

*However, the State Bar needs to make the following additional improvements:*

- ☒ *Adopt additional collection methods to increase the amounts it actually collects from disciplined attorneys.*
  - ☒ *Clarify and enforce policies regarding its purchasing cards, business expense account, and contracting.*
- 

Chapter 342, Statutes of 1999, directed the State Bar of California (State Bar) to contract with the Bureau of State Audits to conduct a performance audit of the State Bar's operations from July 1, 2000, through December 31, 2000. We found that the State Bar has made some improvements to its disciplinary process and has taken steps to ensure that mandatory fees are reasonable and do not support voluntary programs. However, we also found that the State Bar does not consistently follow its improved procedures for using purchasing cards, charging its business expense account, and awarding contracts. Specifically, we found:

### **Finding #1: The State Bar has made some improvements to its disciplinary process.**

Since we issued our May 1996 report on its operations, the State Bar has changed significantly its disciplinary process and its cost model for recovering the expenses associated with this process. It has implemented a priority system to ensure that its staff identify, investigate, and prosecute promptly those cases that pose the most significant threat to the public. In addition, the State Bar has implemented a policy to review random cases periodically to ensure that its staff's actions are consistent with case law and standards and with State Bar policy and procedures. Moreover, the State Bar has revised the cost model for the disciplinary process to include all types of costs that it can recover from disciplined attorneys. Using the new model, the State Bar has more than doubled the highest amount it can charge an attorney for the costs of investigating and pursuing disciplinary action. Overall, these changes have increased the efficiency and reliability of the disciplinary process, which protects the public by addressing attorney misconduct.

**Finding #2: The costs the State Bar charges to disciplined attorneys have increased, but efforts to recover them remain poor.**

The State Bar has revised the cost model it uses to determine the amounts to charge disciplined attorneys. This change has increased the amounts it bills attorneys for discipline costs. However, the cost model uses 1997 salaries instead of the most current salaries for State Bar employees. Because it has not updated the salaries in the cost model, the State Bar is not billing for all costs that it is entitled to collect. In addition, the State Bar recovers only a small portion of these costs from offending attorneys and its success rate for collecting these costs declined in 2000 compared with its 1995 rate. Because the State Bar's recovery efforts are poor, it uses a greater portion of membership fees than necessary to support its Client Security Fund and disciplinary programs. Consequently, members must pay a fee that is higher than necessary.

We recommended that the State Bar maximize the costs it can recover by using figures for current salary costs to update the cost model. In addition, we recommended that the State Bar pursue additional collection efforts, such as the State's Offset Program.

***State Bar Action: Partial corrective action taken.***

The State Bar reported that its consultant updated the cost model based on the new bargaining unit agreements with its employees that became effective in January 2002. The State Bar also indicated it has purchased ownership of the cost model from its consultant. In addition, the State Bar reported that it has had preliminary discussions with legislators and legislative staff about possible participation in the Offset Program and that it is developing legislation for possible introduction in the next legislative session.

**Finding #3: The State Bar has taken steps to ensure that mandatory fees are reasonable and do not support voluntary programs.**

The State Bar has improved its accounting for the voluntary and mandatory fees it charges members and for the programs that the fees support. As a result, it can better ensure that mandatory fees are reasonable and that they do not fund voluntary programs. Also, the State Bar has willingly determined the amount of mandatory fees it needs to perform its required functions. As a result, both the State Bar and its members have

greater assurance that members who choose to pay only the mandatory fees do not bear the costs of voluntary programs. In addition, the State Bar is better able to justify the level of fees it annually charges its members.

**Finding #4: The State Bar does not consistently follow its improved procedures for using purchasing cards, charging its business expense account, and awarding contracts.**

The State Bar has established controls over the purchasing card program used by its employees. However, it must clarify which purchases constitute appropriate business expenses and which costs employees should charge to the State Bar's business expense account. In addition, the State Bar must enforce more strictly its policy requiring receipts from employees who use the purchasing cards. Although the problems we identified in the use of purchasing cards involved less than \$8,000, weaknesses in controls increase the risk that employees could abuse the purchasing card program. Also, the State Bar has developed a competitive bid methodology for attracting and awarding contracts, but the procedures are not always followed. Furthermore, payments are not always made in accordance with contract terms. Finally, we found two instances in which vendors provided services to the State Bar without prior authorization. Because of these weaknesses, the State Bar cannot be sure that the price it pays for goods and services is competitive or reasonable and that purchases are necessary.

We recommended that the State Bar clarify its definitions of purchases that constitute appropriate business expenses and enforce its policy requiring receipts for purchases exceeding \$25. In addition, we recommended that the State Bar require its employees to charge all discretionary spending to the business expense account, and monitor total charges to this account. Finally, we recommended that the State Bar enforce its policies and procedures for contracting.

***State Bar Action: Partial corrective action taken.***

The State Bar reported it has updated its procurement manual to provide additional clarification on its purchasing card program and contracting policies and began conducting mandatory training sessions in March 2002. In addition, the State Bar reported that accounting staff check for receipts for purchases exceeding \$25 as part of the account payable review

process. Also, staff check to see that any discretionary spending is charged to the business expense account. Finally, the State Bar indicated it has issued an administrative advisory stating that no business expenses may be incurred beyond the account budget.

# INFORMATION TECHNOLOGY

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## ***The State Needs to Improve the Leadership and Management of Its Information Technology Efforts***

REPORT NUMBER 2000-118, JUNE 2001

Employment Development Department, Franchise Tax Board, Department of Transportation, and Department of Information Technology's responses as of June 2002 and Department of Health Services' response as of August 2002

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

*Our review of the State's leadership and management of its information technology (IT) projects revealed the following:*

- ☒ *The Department of Information Technology (DOIT), which is responsible for overseeing the State's efforts to plan, develop, and evaluate IT, needs to provide stronger leadership and guidance to state departments.*
  - ☒ *DOIT has not sufficiently met other responsibilities such as completing a statewide inventory of projects, releasing key standards that establish common rules for projects, and using state-mandated advisory councils consistently.*
  - ☒ *Four major projects we reviewed experienced varying degrees of cost overruns and delays, but two of these projects had significant project management problems.*
- 

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the State's management of information technology (IT). We were asked to review a number of specific areas, including strategic planning for IT activities, the project approval process, and coordination of similar IT activities. In addition, we were asked to compile an inventory of the State's major IT projects. We found that:

### **Finding #1: The statewide IT plan is out-of-date and does not communicate priorities for projects.**

The Department of Information Technology (DOIT) has not revised the existing statewide IT plan since it was issued in 1997. The existing plan does not deal with several critical IT issues and changes in technology, including the governor's electronic government (eGovernment) initiative that requires all departments to consider ways to deliver services to citizens over the Internet. Because most objectives in the plan are outdated, the State is left with few relevant measures to gauge its progress. Further, unlike the plans of other organizations, the statewide IT plan does not include priorities for large projects to ensure that the most important projects are considered first.

We recommended that DOIT, in conjunction with the departments, the governor, the Legislature, the Department of Finance, and other relevant parties, update the statewide IT plan and ensure that the plan includes current measurable objectives and communicates priorities for approval and funding of projects.



***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #2: DOIT has not sufficiently reviewed and approved departments' IT strategic plans.**

Although state law directs DOIT to approve departments' IT strategies, DOIT indicates that it has only sporadically reviewed these plans in the past, because higher priorities, including the year 2000 effort, merited the assignment of its resources. Of eight departments we reviewed, all had prepared plans between 1997 and 2000, but DOIT had reviewed none. Consequently, it has not consistently guided departments' planning efforts at the earliest stages to ensure the development of viable projects. Without DOIT approval and review, departments' IT strategic plans may have weaknesses, be inconsistent with the statewide IT plan, or in the absence of an updated statewide plan, reflect philosophies that DOIT believes are inappropriate.

DOIT should implement a process to review departments' IT strategic plans to ensure they are consistently evaluated for their compliance with the statewide IT strategy.

***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #3: Departments receive unclear guidance for managing their IT projects from DOIT.**

Because DOIT does not always consolidate, update, or clarify its IT policies, departments receive unclear guidance. State law charges DOIT with updating its policies to reflect the State's changing IT needs and publishing them in the State Administrative Manual or in Management Memos. Although DOIT has published policies, it has not consolidated them to improve departments' ability to follow its direction and still publishes some rescinded policies that conflict with current policies. Such practices can create confusion and misunderstanding. In addition, DOIT has not clarified its guidance to evaluate and formalize the alternative procurement process.

We recommended that DOIT consolidate the various sources of policy and guidance, remove outdated policies from published documents, and revise policies as needed to reflect changing state needs. In addition, we recommended that DOIT clarify the applicability of the alternative procurement process, evaluate the process in conjunction with the Department of General Services, and provide information to departments about how the process could be most effectively used.

***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #4: DOIT has not adequately documented its basis for approving projects or ensured that departments properly assess risks.**

DOIT cannot demonstrate it has consistently and sufficiently analyzed whether departments are properly conceiving and planning IT projects because it often does not document the basis for its decisions to approve IT projects. For 10 proposed IT projects we reviewed, with development costs totaling \$35 million, DOIT could not provide sufficient evidence that it thoroughly analyzed them. In addition, despite the fact that IT projects are inherently risky, DOIT does not ensure that departments appropriately assess their risks. In fact, in our review of the 10 projects, we found little evidence that DOIT evaluates departments' risk assessments. Further, DOIT allows departments to assess risk late in the approval process of large, critical IT projects that are required to use the alternative procurement process. DOIT began in May 2001 to improve this process; however, the weaknesses in DOIT's review of feasibility and risk for proposed IT projects could result in it failing to detect poorly conceived efforts.

We recommended that DOIT continue its efforts to improve its project review and approval process. However, it should ensure that the changes result in a thorough evaluation of proposed projects and that it documents the basis for approval decisions. As part of this process, DOIT should properly analyze departments' risk assessments. In addition, DOIT should require departments to assess risks at the beginning of the alternative procurement process.

***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #5: DOIT could improve its oversight of departments' IT efforts.**

Based on our review of the project reports for nine projects, we found limited evidence that DOIT used the reports as tools to monitor departments' IT projects. The project reports include periodic progress reports to summarize the status of the project, which DOIT typically requires the department to submit, and independent validation and verification (IV&V) reports from consultants that evaluate the primary vendor's performance. Further, DOIT does not require departments to report two critical pieces of information on projects' progress: monthly costs and revised estimates of total costs compared with the budget, and actual and revised project completion dates for project phases compared with the original schedule. Additionally, departments do not always submit special project reports—required when projects experience or expect to experience significant changes—when they should, making it difficult for DOIT to properly oversee their efforts. When departments do not report to DOIT as they should, they frustrate the intent of DOIT's oversight role.

DOIT has not ensured that departments submit reports evaluating their IT projects after completion. Moreover, for the relatively small number of post-implementation evaluations it has reportedly received, DOIT has not performed the analysis necessary to ensure that projects are meeting departments' goals. As a result, departments have not been held accountable for the promised benefits from planned IT projects. DOIT believes that the current post-implementation evaluation process does not provide value, and it plans to reengineer the process by fiscal year 2003–04.

DOIT should improve its project oversight by requiring that project progress reports include the project's monthly actual costs and revised estimates of total projected costs compared with the budget, and actual and revised projected completion dates for project phases compared with the original schedule. In

addition, DOIT should ensure that analysts sufficiently review and document their oversight of projects and track the receipt of required reports. It should also hold departments accountable for the benefits expected and incorporate lessons learned from their IT project development by ensuring that they submit post-implementation evaluation reports and then review these reports.

***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #6: DOIT has not taken sufficient action to coordinate information technology projects.**

Despite the mandate of state law, DOIT does not have an established process to ensure that departments do not independently develop statewide IT applications or duplicate other departments' efforts. Instead, departments have mostly relied on informal networking to identify similar projects at other departments. In addition, DOIT has not continuously maintained an IT project inventory as required by state law. The project inventory, if properly designed and updated, would help coordinate activities and enhance the State's ability to make a conscious, proactive evaluation of how it allocates its limited resources for IT projects. To gather information for this inventory, DOIT surveyed departments about their IT projects in November 2000, but had not published a project inventory as of June 2001. Without consistent coordination, the State lacks assurance that it can identify overlapping or redundant IT efforts, and departments do not benefit from each others' knowledge of technology and development approaches.

To promote coordination and avoid redundant efforts, DOIT should establish a formal mechanism to initiate discussions between departments that are developing projects based on similar technologies or processes. To facilitate this coordination and improve project oversight, DOIT should complete its IT project inventory, ensure that departments' reported data are accurate, and update this information. DOIT also needs to consider how departments and the Legislature can effectively access this information, taking into consideration privacy issues and other concerns that may limit its release.

***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #7: DOIT has not finalized several key standards and plans to develop others.**

State law directs DOIT to develop standards to guide departments' IT efforts. Standards establish common rules and can encourage the use of best practices for collecting, sharing, protecting, and storing data, as well as ensuring the accessibility and usability of systems. Although DOIT indicated in June 2001 that security and infrastructure standards are final drafts, it does not expect these standards to be through the review and approval process until October 2001. Because the application development and accessibility standards are in preliminary draft form and the data standard is not yet started, it is unclear when DOIT will issue these standards. DOIT also plans to develop standards for software licensing and asset management, e-mail, office automation, and document exchange. Until standards are finalized, departments will continue to conceive and develop IT projects without the framework needed to ensure that their efforts meet common rules and are consistent with best practices.

We recommended that DOIT expedite its work on implementing standards by determining which standards need to be addressed first and focusing their efforts accordingly. Further, DOIT should work with departments to ensure that all necessary standards have been implemented.

***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #8: DOIT has inconsistently used its advisory councils.**

DOIT has not consistently used two state-mandated advisory councils established to provide advice on its activities. One required council—the private commission—should consist of IT practitioners from private, academic, nonprofit, and governmental sectors and is intended to provide advice on long-term

trends and strategies, key policies, emerging technologies, and best practices. The second required council—the public committee—should consist of representatives from state agencies and is intended to advise DOIT on successful IT management, identify critical success factors, and recommend policy changes. It is unclear if DOIT regularly met with the private commission in 2000, but DOIT has more recently begun meeting with it regularly to discuss pressing issues. DOIT did not meet with the public committee for most of 2000. In addition, DOIT could not provide us any written findings or recommendations made by the public committee, even though state law indicates they must be made available to interested parties. Further, DOIT did not sufficiently document its meetings with the private commission or public committee, so we could not verify if DOIT met with them or ensured that they provided DOIT the advice intended by law.

We recommended that DOIT continue to meet with the private commission and the public committee on a regular basis to guide its strategic planning efforts, provide input on new policies, and ensure that the State follows best practices. Additionally, DOIT should ensure that the public committee makes all findings and recommendations in writing, as required by state law.

***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #9: DOIT has not fulfilled promised IT initiatives or sufficiently addressed its statutory responsibilities.**

Since its inception, DOIT has pledged action on key initiatives or planned tasks in its annual reports to the Legislature. However, DOIT has not fulfilled all of its promises or sufficiently addressed its statutory responsibilities. For example, DOIT indicated in its 1998 annual report that it would enable departments to update the statewide project inventory over the Internet, but this capability still does not exist. DOIT states that these initiatives were established by the previous administration and that the current administration cannot be held accountable for the promises and initiatives of that administration. DOIT's lack of progress on its promised initiatives and responsibilities may lessen its credibility.

We recommended that DOIT establish timelines and goals for meeting future initiatives. If DOIT does not believe it can complete initiatives within established guidelines, it should communicate its priorities and resource requirements to the Legislature. In addition, it should notify the Legislature when changes in the State's IT environment prompt adjustments to these priorities or resource requirements.

***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #10: DOIT has not consistently used an internal strategic plan to guide its efforts and maximize its use of resources.**

Although good management practices suggest that DOIT develop and implement an internal strategic plan to guide its efforts and maximize the efficient use of its resources, it has not consistently used one. DOIT's authorizing legislation requires that it be involved in a variety of activities, and meeting these responsibilities stretches its resources. In addition, DOIT lost 8 of 11 key managers during fiscal year 2000-01, which hurts its ability to identify strategic priorities. Without the direction of an internal strategic plan to define what it needs to do and what activities it should address first, DOIT's efforts have been scattered over a variety of initiatives, and it has performed inconsistently.

DOIT should adopt an internal strategic plan to identify key responsibilities and establish priorities. This plan should clearly describe how the organization would address its many responsibilities and build on past efforts to the extent possible.

***DOIT Action: DOIT closed as of June 30, 2002.***

We will discuss the extent to which the State is implementing recommendations that were directed to DOIT and are still relevant in our report on the State's IT governance structure, report number 2002-111, which is to be issued in February 2003.

**Finding #11: Although the Tax Engineering and Modernization (TEAM) project of the Employment Development Department was generally better managed than others we reviewed, it still experienced some problems during development.**

The TEAM project is a redesign of the Employment Development Department's processing of employer tax returns and payments. Its projected cost is \$71.7 million, which is 6 percent more than the original projected cost. The project began in June 1997 and was completed in April 2001, 22 months later than originally planned.

We found that the high turnover of critical vendor staff—the project manager and the quality assurance manager—and the lack of sufficient vendor staff as well as their inadequate skills, likely contributed to most of the nearly two-year delay in development of TEAM and contributed to the vendor delivering poor quality products. The Employment Development Department was also inconsistent in its development of a clearly defined and documented project management plan. For example, the initial plan did not include certain critical elements such as a schedule of all tasks necessary to complete the project. Prior to February 1999 the department also did not have any formal process to properly control and monitor project changes. The current process allows the project team to appropriately track and monitor changes. We also observed certain weaknesses in the IT security over TEAM. The department intends to implement appropriate security procedures by June 2002.

The Employment Development Department should take the following actions to improve the management of IT projects and to help ensure that projects are completed on time and within budget:

- Ensure that the vendor provides sufficient staff with the necessary training and experience.
- Use an effective project management plan before beginning to develop each project so it can monitor the progress of the projects.
- Ensure that it establishes and uses a process to control and monitor project scope changes that requires changes be adequately reviewed before they are made.
- Correct the IT security weaknesses we identified.



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

The Employment Development Department reports that based on the lessons learned from the TEAM project and our recommendations, it has updated its project management practices. Additionally, to ensure that vendors provide sufficient and appropriate staff on IT projects, it has developed standard contract provisions related to staffing and a checklist to use during contract negotiations. Further, the Employment Development Department reports that it has updated its security policies, procedures, and guidelines to address the security weaknesses we identified. It plans to have a contractor perform a security review, but does not expect to hire the contractor until early 2003.

**Finding #12: The Accounts Receivable Collection System (ARCS) of the Franchise Tax Board was generally better managed than other projects we reviewed and experienced only minor problems during development.**

The ARCS project consolidates various automated and manual collection systems into one system with the intent of making the Franchise Tax Board's collection efforts more effective and efficient. ARCS cost \$36.3 million, 10 percent more than the original estimate. The project began in April 1998 and was completed in March 2001, nine months later than originally planned.

ARCS is complete and generally functioning as intended; however, the Franchise Tax Board could have minimized potential problems by employing an IV&V consultant. Instead, the Franchise Tax Board chose to hire an oversight consultant, whose review focused on the project's finances, personnel, schedule, and documentation rather than a review of project requirements, design, testing, or implementation in detail, as an IV&V consultant would have done. Lacking this detailed review, the Franchise Tax Board did not have the benefit of information that would have enabled it to make better-informed decisions had problems developed with the quality of the vendor's work.

We recommended that the Franchise Tax Board use IV&V consultants as well as project oversight consultants throughout the development of its complex projects.

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

The Franchise Tax Board reports that it is now employing IV&V vendors on its complex projects.

**Finding #13: The Department of Health Services (Health Services) had significant weaknesses in its Children's Medical Services Network Enhancement 47 Project (CMS Net E47) because it did not always plan and develop its project appropriately.**

The CMS Net E47 project is intended to enhance an existing system by linking it with the State's medical and dental fiscal intermediaries. CMS Net E47 is currently estimated to cost \$10.2 million and is 82 percent over the original estimate. CMS Net E47 began in January 1998 and is expected to be completed in December 2002, 15 months later than originally planned. However, certain elements, which 46 counties currently use, were implemented in April 2001.

We observed that Health Services' primary weakness in planning and procurement was how it obtained the services of vendors to develop CMS Net E47. For example, rather than following the best practice of outlining its business problem and requesting solutions from vendors, Health Services developed the specifications itself. In addition, instead of selecting the vendor on the basis of best value—the best combination of experience, solution, and cost—Health Services awarded the contract to the vendor with the lowest bid. Health Services also did not structure the contract to withhold a portion of the payments to the vendor until the vendor performed satisfactorily.

We had several concerns regarding Health Services' design, development, and implementation of CMS Net E47. For instance, we had concerns that certain basic project management tasks were not performed consistently and Health Services did not initially assign a project manager with appropriate training or authority. We also observed certain weaknesses in the IT security over CMS Net E47. Health Services is studying how to implement appropriate security procedures. Finally, because Health Services used two individuals from the same consulting firm to help it manage CMS Net E47 and to provide IV&V services over CMS Net E47, it may have made it difficult for the IV&V consultant to objectively oversee the performance of the project manager. These problems have likely contributed to the project's cost increase and delay.

Health Services should take the following actions to improve the management of IT projects and to help ensure that projects are completed on time and within budget:

- Select vendors that propose the best solutions at the best value.
- Structure contracts with vendors to protect the interests of the State, including provisions to pay vendors only after deliverables have been tested and accepted.
- Use sound project management practices during the design, development, and implementation phases of projects and specifically ensure that it assigns project managers with the appropriate training and authority.
- Correct the IT security weaknesses we identified.
- Ensure independent oversight of its projects by hiring IV&V consultants from firms that are different from those providing other services to the project.

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

Health Services indicates that it established a separate unit to oversee IT project management and planning. This unit's oversight responsibilities will also include vendor selection and contracts process for IT projects. To assist Health Services in developing project management procedures, it hired a consultant to recommend the structure for a project management office. The consultant completed the study in March 2002, and Health Services is implementing the recommendations. In addition, Health Services reports that it is modifying its practices to ensure that contracts are deliverable-based and that payment is made only upon successful completion of project deliverables. Further, it has developed standard tasks and deliverables for use in hiring IV&V contractors. Finally, Health Services indicates that it is currently revising its information security policy to include a more comprehensive policy on protecting IT assets.

**Finding #14: The Department of Transportation (Caltrans) had significant weaknesses in its Advanced Toll Collection and Accounting System (ATCAS) because it did not always plan and develop its project appropriately.**

The ATCAS project will replace the existing toll collection and accounting system and install electronic toll collection on all state-owned toll bridges. The current projected cost is \$56.1 million, 102 percent more than the original projected cost of \$27.8 million. ATCAS began in June 1993 and was expected to be completed in December 2001, 59 months later than originally planned.

The main weakness in Caltrans' planning approach was that it failed to develop a supportable justification and a well-defined problem statement for ATCAS. In addition, it did not employ a project management plan to help it identify and resolve problems until two years after development of ATCAS began. Further, Caltrans developed the technical specifications to the proposed project rather than letting vendors propose their designs and therefore shifting more responsibility for ATCAS's success to the vendor. These planning omissions likely played a part in ATCAS's cost and schedule overruns.

During the development of ATCAS, Caltrans did not always use sound project management practices. Caltrans did not always perform testing of project components as it should have and went ahead with the partial deployment of ATCAS without completing acceptance tests to ensure that the vendor's prototype functioned as intended. Caltrans repeatedly assigned project managers who had little or no experience or training managing an IT project of this size or complexity. Further, Caltrans could not demonstrate that it had sufficiently monitored ATCAS's progress. Finally, despite the fact that it was a complex and costly project, Caltrans failed to employ an IV&V consultant for almost the entire project. Using an IV&V consultant earlier in the project might have avoided some of the cost overruns and delays that ATCAS experienced.

We recommended that Caltrans take the following actions to improve its management of IT projects and to help ensure that projects are completed on time and within budget:

- Develop a problem statement for each IT project that adequately describes the problem the project is intended to solve with quantifiable goals, and a supportable business case for each project that justifies its funding.
- Develop an effective project management plan before beginning to develop each project so it can monitor the progress of the project.
- Allow vendors to propose solutions and the technical specifications for its large and complex IT projects.
- Ensure that testing is completed at appropriate phases to identify and resolve problems before moving ahead.
- Ensure that it uses sound management practices during the development of each project, such as assigning qualified individuals with appropriate experience and training to manage the project, documenting key discussions and decisions, and monitoring progress through periodic reports.
- Use IV&V consultants on complex IT projects.

***Caltrans' Action: Partial corrective action taken.***

To improve and standardize its project management practices, Caltrans reports establishing a separate project management division. This division is in the process of standardizing Caltrans' project management and development procedures. In addition, Caltrans reports that the division has provided awareness presentations to its districts and headquarters IT staff on departmental IT policies and procedures. Further, Caltrans states that it intends to allow vendors to propose solutions and the technical specifications for its large and complex projects. Finally, Caltrans states that it will use IV&V consultants on specific IT projects as it deems appropriate.

# DEPARTMENT OF CORRECTIONS

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## ***Its Fiscal Practices and Internal Controls Are Inadequate to Ensure Fiscal Responsibility***

REPORT NUMBER 2001-108, NOVEMBER 2001

Department of Corrections' response as of December 2002

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

***Our review of the California Department of Corrections' (department) fiscal practices and internal controls revealed:***

- ☑ ***Spending plans, which are used to control program expenditures and to identify potential shortfalls, are inaccurate and do not align with the department's spending authority.***
  - ☑ ***Excessive use of custody staff overtime and sick leave, combined with inadequate funding, is the primary cause of its budget shortfalls.***
  - ☑ ***Improved contracting practices could result in hundreds of thousands of dollars per year in savings and prompt payments to contractors.***
  - ☑ ***Proactive strategies for reducing costs related to legal actions are not fully implemented.***
- 

**W**e evaluated the Department of Corrections' (department) budgeting practices, fiscal management, and contracting practices. We found the department practices in each area were inadequate to protect the best interests of the State. Specifically, we found:

### **Finding #1: Unrealistic spending plans hinder the department's ability to manage its fiscal situation effectively.**

The department's spending plans, which it uses to control program expenditures and to identify potential shortfalls, do not provide an accurate base from which it can make informed fiscal decisions. In fact, we found variances as large as \$168 million between its spending authority and spending plan in one year. This situation has occurred because the department failed to ensure that its spending plans correspond to its spending authority. This failure may have contributed to the department's past funding shortfalls.

To manage its fiscal operations more effectively, we recommended that the department ensure its spending plans correspond to its spending authority.

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

The department reported that its fiscal year 2002–03 initial allotments were issued in August 2002 and tie to its spending authority. Subsequent budget changes will be issued according to updated budget authority and will remain within spending authority.

**Finding #2: The department needs to improve the way it communicates to the Legislature.**

Because of differences between the department's spending authority and how it spends its funds, the department should prepare and present a report to the Legislature that reflects its spending plans and realistic projections for where it expects its expenditures to occur. Such a report would allow for resolution during the budget process and ultimately should result in spending authority and spending plans that realistically reflect where the department is spending its funds.

In light of its continuing budgetary challenges, the department should report the status of its financial position to the Legislature each November, February, and May.



***Department Action: None.***

The department states that it cannot comply with this recommendation due to a lack of staff resources or adequate data systems. The department also believes that the prescribed time frames for submittal of the reports is unrealistic given the current parameters for securing month-end accounting data necessary for preparing the reports. Thus, the department stated that no action will be taken unless specific legislative direction and the necessary resources are received. However, we believe the department's current data systems are adequate for preparing the suggested report.

**Finding #3: The department needs to reevaluate its standard costs.**

To adjust the department's spending authority and spending plans for increases and decreases in inmate and parolee populations and in the number of staff needed to guard and provide services to inmates, the department uses standard cost factors. However, we found the department did not update these standard costs as recommended by the department staff that redesigned them. Consequently, the information used to compile the standards are now over four years old and do not reflect the department's true needs.

To better match its budgeted funds to its actual expenditures, we recommended that the department periodically review and update its standard cost formulas.

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

The department contracted for an independent review to develop a new base budget methodology that will provide cost measurements (standard costs) that represent the department's true costs. The base budget methodology was completed on September 30, 2002, and is undergoing final review by the department. The department will work with the Department of Finance towards implementing the base budgeting methodology. Legislative review and concurrence will also be required once the methodology is finalized. In the interim, the department has submitted numerous funding requests, which are pending review and consideration, to address standard cost items that are driving structural shortfalls.

**Finding #4: The department's fiscal monitoring activities are inadequate.**

Because the department uses the inaccurate spending plan figures, discussed above, as the basis for its primary fiscal management system (monthly budget plan review), it is not using a reasonable basis for fiscal decision making. In addition, department fiscal analysts spend much of their time reviewing methods used by institutions to project expenditures instead of analyzing the problems and issues presented. Finally, even when its monthly budget plans identify problems, the department rarely takes corrective action. Until the department resolves these issues, its fiscal monitoring efforts will be futile.

To improve its fiscal management, we recommended that the department fully implement and use its new automated monthly budget plan review and ensure that it prepares and implements corrective action plans to aid in the resolution of projected spending deficiencies.

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

The department's automated monthly budget plan has been implemented statewide and effective November 1, 2001, the department is conducting monthly evaluations of the plans. In addition, the department director issued a memorandum on October 31, 2002, implementing a new quarterly fiscal review process instead of an annual fiscal review. The monthly budget plans have become the basis for the first quarterly fiscal review that was conducted in November 2002. The fiscal reviews focus on the implementation of best practices, deficit reduction plans, and reviews of the corrective action



plans from the previous fiscal review and processes. The director also issued another memorandum on July 9, 2002, which requires all institutions to respond to the fiscal corrective action plan issues.

**Finding #5: The department can improve its deficit analysis process.**

The department asserted that there are 12 causes for its recurring budget shortfalls; however, we found that the department's conclusions as to the origins of these deficits were often lacking what we would consider sound financial analysis. Specifically, the department's analysis for 8 of its 12 asserted causes lacked a comparison of budget-to-actual expenditures and the department could not provide support for the base values used in one analysis. In addition, we found that although the department may have incurred shortfalls in particular expenditure line items, in two cases a higher level analysis of the expenditure category or program indicated that sufficient funds were available in other line items to cover the shortfall.

We reviewed four years of the department's spending plans and expenditures for five expenditure categories, and although department expenditures increased in each of the categories, we found that in all cases the amount reflected in the department's spending plan had decreased in one or more years. Our analysis indicates that the department can manipulate the shortfall in an expenditure category by decreasing the posting to its spending plan.

To improve the way it analyzes areas contributing to budgetary challenges, the department should compare year-to-date and projected expenditures to a budget that aligns with its spending authority. The department should perform this analysis in conjunction with an overall program analysis to ensure that shortfalls in one area cannot be covered with surplus from another area.



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

The department reported that it is now continuously reconciling its spending plans with its spending authority and that its monthly budget plan review provides an effective tool for monitoring the department's overall fiscal condition. Based on the August 2002 monthly budget plan, the department has been apprised of a potential deficiency for fiscal year 2002–03. The department stated that funding

requests have been submitted to address the structural deficiency. However, the department did not address whether it would conduct a program analysis in conjunction with its expenditure line item reviews.

**Finding #6: Eliminating excessive overtime would save the State at least \$42 million per year.**

In fiscal year 2000–01, the department incurred more than \$176 million in overtime expenditures for custody staff—nearly double its spending authority of \$89 million. Excessive overtime is primarily caused by excessive custody staff vacancies and overuse of sick leave. In fact, a department analysis of its overtime expenditures revealed that 72 percent of the overtime was avoidable, meaning that a scheduled person on regular time could have filled the need—if available. The department could reduce its budget shortfall by at least \$42 million by replacing costly overtime expenditures with regular time pay when possible.

To resolve its funding shortfall for custody staff, the department should act aggressively to fill all vacant custody staff positions and continue its efforts to lower to budgeted levels its staff's use of sick leave.

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

The department reported that every effort is being made to fill vacant positions at the institutions. For example, its aggressive recruitment efforts resulted in a 30 percent increase in correctional officer applicants for the year ended in July 2002. In addition, the department implemented a staggered academy approach concept, which will result in new academy graduates reporting to institutions on a more frequent basis. The department has also amended its union contracts to allow them to post 400 additional vacation and holiday relief positions. As of October 31, 2002, the department reported that it had 586 vacant permanent full-time correctional officer positions versus 1,040 positions on June 30, 2002.

On June 28, 2002, the director issued a policy memorandum to clarify the department's and the union's sick leave usage policies and the department's expectation of managers and supervisors on the enforcement of these standards. The department reported that as of September 2002 it had experienced an increase of 346,115 hours of sick leave usage since the terms and conditions of the agreement with the correctional officer's union changed in January 2002.



**Finding #7: The department has failed to act promptly to control workers' compensation costs.**

Excessive workers' compensation costs contributed approximately \$28 million to the department's funding shortfall in fiscal year 2000–01. However, the department has failed to take action to control these escalating costs—further evidence of the department's failure to take action to protect the State's interests when it identifies fiscal problems.

To reduce workers' compensation costs, we recommended that the department continue to develop and implement a mitigation strategy as soon as possible.

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

The department is in the process of developing a three-year workers' compensation cost containment strategy plan. The plan includes six areas that will aid the department in controlling workers compensation costs. The six areas include a fraud program, partnering with other agencies, identifying the role of the return-to-work coordinator (RTWC), developing tools to improve case management, providing education and training to the RTWCs, and developing ways to streamline the process. The department reports that its new Disability Management Unit has referred 46 cases for investigation of suspected fraudulent activity and/or abuse.

**Finding #8: Changing job placement programs would increase placements and reduce costs.**

The department could save over \$700,000 per year and place hundreds more parolees into the work force by expanding its use of the Jobs Plus program (Jobs Plus) and eliminating its use of the Offender Employment Continuum program (Continuum). Parolee job placements through Continuum are more costly than those through Jobs Plus because of the basis used for payments. However, it is unclear why Jobs Plus places parolees into jobs at higher rates.

To maximize its use of contract funds and ensure that it does not incur unnecessary charges, we recommended that the department pay its Continuum subcontractors for each placement of a parolee, just as it does with Jobs Plus contractors. The department should also implement strategies to encourage higher job placement rates for the Continuum contractors.

We also recommended that if the department cannot improve Continuum's placement rates and reduce to a level commensurate with Jobs Plus the cost for each placement, the department should eliminate Continuum and expand Jobs Plus to accommodate those parolees whom the department would have referred to Continuum. In addition, if department staff find the Continuum workshop superior to that of Jobs Plus because it leads to lower recidivism rates, the department should consider revising its contract with Jobs Plus to include a workshop that is similar to that of Continuum.

***Department Action: Pending.***

The department believes it is too early to conclude that one job placement program is better than the other and is waiting for the results of two studies before making decisions on which program warrants future funding. One study is not due until approximately January 2004. In addition, the department reported that since December 2001, Continuum's unit cost per direct placement has declined by approximately \$49. The department also reported increases ranging from 20 percent to 42 percent in Continuum job placements, job referrals, workshop attendance, and workshop graduations. However, the department did not address whether it had considered revising its Jobs Plus contract to include a workshop that is similar to that of Continuum.

**Finding #9: The department is paying excessive indirect costs for its Jobs Plus contract.**

The department paid but could not support nearly \$24,000 in indirect contract costs to the Jobs Plus contract administrator. In addition, the department could have saved \$150,000 if it had negotiated the current federal indirect cost rate instead of the rate in its contract with Jobs Plus. Using the federal rate is not uncommon as the department used an even lower rate in its previous contract with Jobs Plus.

To further maximize the use of contract funds without incurring unnecessary charges, we recommended that the department obtain and review cost allocation plans for all contracts and seek cost recovery for any unsupported costs. Further, we recommended that the department attempt to negotiate the indirect-cost rate that its contract administrator charges federal programs, or a lesser rate, in future contracts.

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

The department reported that its Line Item Budget Guide (LIBG) was recently revised to allow bidders to use their federal cost allocation plan for department contracts, with specified restrictions. The new LIBG, which includes a requirement for all contractors to maintain cost allocation plans is undergoing a review and approval process. However, the department did not identify the restrictions for using federal indirect cost rates or report whether it had sought cost recovery for any unsupported costs. Finally, the department stated that it is reviewing the policy requiring contractors to maintain current cost allocation plans and that the policy may be revised at a later date; however, the department did not identify its concerns with this policy.

**Finding #10: Some of the substance abuse program's subcontractors do not receive prompt payments.**

Our review of a sample of invoices revealed that some subcontractors have to wait as long as four months to receive payment. Such lengthy delays can have severe repercussions for these subcontractors, forcing some to rely on costly lines of credit to meet their financial obligations and threatening the solvency of other subcontractors. The department is contributing to the payment problems by failing to establish a mechanism for subcontractors to communicate their problems and by not enforcing contractual payment provisions.

Our recommendation to help ensure that contractors and subcontractors receive payments in a timely manner, was for the department to establish a formal complaint mechanism for contractor payment delays or other problems, and to assist in resolving identified problems.

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

The department stated that discussions with primary and second-tier providers have focused on strategies to streamline the payment process and to establish clear lines of communication, with the primary objective to alleviate cash flow problems to all levels of service providers, including third-tier subcontractors. It also responded that specific discussions may include a requirement for all second-tier contractors to include a notification to all third-tier contractors of the appropriate department address, telephone number, and contact person to be contacted if any payment problems

occur. The department has also assessed the current payment flow and implemented changes to the current contracts, which allows a smoother and more efficient payment flow to all levels of service providers. Specifically, the modifications permit both second- and third-tier subcontractors to receive direct payments from the State Controller's Office, thereby eliminating unnecessary layers in the original payment design. The department will also revise future contract language to provide contractors with department personnel and phone numbers to address program contract and payment issues that may arise.

**Finding #11: Inconsistent contract monitoring does not ensure the best use of state resources.**

The department's monitoring of subcontractors is inconsistent, ranging from inadequate in some cases to excessive in others. As a result, the department is not allocating its limited resources in the most efficient, effective manner to ensure the accuracy of contractor invoices and the satisfactory delivery of services.

To use its resources more efficiently and to make sure that contractors and subcontractors comply with contract provisions, we recommended that the department standardize its contract monitoring procedures. These procedures should include a requirement for its primary contractors to provide a list of all subcontractors, including their addresses and primary contacts, so that the department can identify any possible self-dealing and take appropriate action to ensure that all invoices from entities that subcontract with themselves are legitimate. We also recommended that the department establish a procedure for reviewing a sample of invoices, such as 10 percent, for all other subcontractors and establish procedures to schedule and conduct periodic site visits for all contractors and subcontractors.

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

The department stated that its Office of Substance Abuse Programs now maintains a directory of all third-tier contractors and that it is in the process of establishing policies and procedures for the review of third-tier contractors' invoices. The department also reported that a site visit procedure has been developed for these contractors and that the first series of visits occurred in October 2002. After December 2002, ongoing site visits will be scheduled every month and will include a review of parolee services files. The department



also reported that a 10 percent random sampling of invoices will occur on an ongoing basis; however, it did not provide the results of any reviews that it had conducted.

Regarding employment contractor invoices, the department stated that its staff review and approve 100 percent of the invoices in accordance with the State Contracting Manual. Staff also randomly review and verify at least 20 percent of employment placements reported on subcontractor monthly invoices.

**Finding #12: The department overstated the benefits of a recent reorganization of its central administration program.**

In an April 2001 hearing before the Joint Legislative Audit Committee, the department reported that a reorganization of the department's Central Administration Program was responsible for cost reductions of \$19.6 million in fiscal year 2000–01. However, our analysis revealed that the majority of the reported savings—\$13.6 million—relates to what we consider normal year-end budget activities and not to the reorganization.

We recommended that the department continue to conduct evaluations of its budget needs as part of its year-end budget activities and eliminate funding for unneeded items or positions.

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

The department stated that it will continue to evaluate program budget needs on an ongoing basis and realign funding as appropriate.

**Finding #13: The department can improve its efforts to minimize legal expenses.**

The department has not fully implemented all its strategies designed to reduce the occurrence and consequences of costly legal action against the department. Until it does so, it will not be able to manage legal costs as effectively as possible.

To manage potential litigation costs as effectively as possible, we recommended that legal affairs fully implement all its proposed cost-cutting strategies, fix or replace its case-tracking database to provide a stable tracking system for all settlement and judgment costs, and consider the viability of tracking all internal and external attorney costs associated with each legal case.

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

The department recently received approval to fill the positions needed to achieve greater efficiencies and to finalize the implementation of its cost-cutting strategies. It also received approval to implement a new case-tracking database and expects implementation to begin in September 2003. In the meantime, a rudimentary system has been implemented to track both staff and contract counsel hours expended on each case.





# SUPERIOR COURTS

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

REPORT NUMBER 2001-117, FEBRUARY 2002

Administrative Office of the Court's response as of October 2002

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

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

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

*continued on next page*

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

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

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

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

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

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

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

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

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

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

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

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

According to the AOC, it has surveyed each superior court regarding who incurs the cost, provides the service, and retains each undesignated fee. The AOC also stated that it has reviewed the local agreements between the courts and counties and, where appropriate, encouraged the courts to work with the counties to revise the local agreements so that

fees are distributed to the entity that incurred the cost of providing the service. Finally, according to the AOC, the Governor's current budget proposal addresses the issue of transferring undesignated fee revenue.



# VACANT POSITIONS

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

REPORT NUMBER 2001-110, MARCH 2002

Department of Finance and State Controller's Office  
responses as of September 2002 and Department of Mental  
Health's response as of November 2002

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

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

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

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

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

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

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

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

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

In September 2002 the governor approved Chapter 1124, Statutes of 2002, which amended Government Code, Section 12439, to prohibit departments from performing personnel transactions to circumvent the abolishment of vacant positions. As a result, Finance did not issue an explicit policy to prohibit the use of “120” and “607” transactions to preserve vacant positions from abolishment. Despite the changes in state law, the SCO has not yet issued guidance to departments on processing the transactions consistent with the amended statute. Further, the SCO has not provided to Finance any reports of “120” and “607” transactions for Finance’s analysis and review. Finally, three of the five departments we visited reported to us they have taken actions to discontinue or minimize the use of “120”

and “607” transactions to circumvent state law. Another department stated that it continues to eliminate unneeded vacant positions from its budget. The remaining department stated it will maintain adequate documentation to ensure that “120” and “607” transactions are used for appropriate reasons.

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

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

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



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

Chapter 1124, Statutes of 2002, amended state law to allow the six consecutive monthly pay periods to occur within one fiscal year or between two consecutive fiscal years. As a result, the SCO has initiated the necessary changes to its position control system and estimated it will complete the changes by early 2003. It plans to identify vacant positions that cross fiscal years in August 2003.

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

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

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

***Legislative Action: Corrective action taken.***

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

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

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

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

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

The SCO stated it has completed modifications to its system to track five different position changes. However, it has not provided to Finance reports of "120" transactions for Finance's analysis of potential misuses of the transactions.

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

The Department of Mental Health (Mental Health) did not submit two transactions to Finance, even though they involved reclassifications to positions above the minimum salary level required for Finance's approval. Mental Health believed one of these transactions did not need Finance's approval because

it downgraded a position and the related salary. Nonetheless, Finance staff stated that both transactions needed its approval.

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

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

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

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

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

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

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

Finance stated that the Budget Act of 2002, Section 31.60, directed it to abolish at least 6,000 positions from all positions in state government that were vacant on June 30, 2002. The section also authorized Finance to eliminate at least \$300 million related to the abolished positions. The section further required Finance to report to the Legislature on the specific positions abolished. Finance reported in November 2002 that it abolished 6,129 positions and \$300.4 million. However, our review of Finance's report revealed that it included 560 public safety positions, representing \$23.5 million in cost savings, that Section 31.60 excluded from abolishment. Additionally, we found errors that understated the abolished positions by 39 and cost savings by \$6.7 million. Moreover, we could not determine whether the positions Finance abolished included any that had been eliminated by other provisions of law. Chapter 1023, Statutes of 2002, also directs Finance to abolish at least 1,000 vacant positions by June 30, 2004, and to report to the Legislature on the specific positions abolished.

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

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

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

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

Finance stated that the Budget Act of 2002, Section 31.70, authorized it to reinstate up to one-half the funding reduced by Section 31.60 for fiscal year 2002–03 appropriations to ensure that departments have sufficient levels of funding. Finance required departments to request the reinstatement of funding by November 2002.

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

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

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



***Finance Action: None.***

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

# ENTERPRISE LICENSING AGREEMENT

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

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

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

*Our audit of this acquisition revealed the following:*

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

*continued on next page*

### **REPORT NUMBER 2001-128, APRIL 2002**

**Department of General Services and Department of Finance's responses as of October 2002<sup>1</sup>**

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

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

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

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

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

- ☑ *Nearly 10 months after the ELA was approved, no state departments had acquired the new licenses, which may be due to the fact that General Services had not issued instructions to departments on how to do so.*
  - ☑ *General Services used an inexperienced negotiating team and limited the involvement of legal counsel in the ELA contract. As a result, many contract terms and conditions necessary to protect the State are vague or missing.*
  - ☑ *Our legal consultant has advised us that a court might conclude that the ELA contract with Oracle is not enforceable as a valid state contract because it may not fall within an exception to the State's competitive bidding requirements.*
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DOIT received only 21 responses, 5 of which indicated a possible interest in purchasing any additional Oracle products under a consolidated agreement in the near future.

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

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

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

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



***Finance Action: None.***

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

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

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

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

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



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

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

In March 2002, Finance, General Services, and DOIT developed a draft process for statewide software licenses that defined specific roles and responsibilities for the three departments and prescribed specific analytical and approval procedures. However, this process was not formally approved due, in part, to the sunset of DOIT and the adoption of Control Section 11.10 of the Budget Act of 2002 that will fulfill some of the recommendations.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

On July 23, 2002, the ELA for Oracle database licenses and maintenance support was rescinded. However, General Services stated that it would ensure sufficient resources and expertise are assigned to any future ELA proposals.

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

The task force also recommended that General Services ensure active legal participation in all high-risk transactions. General Services stated that full implementation of this recommendation will require additional legal resources. However, in the interim, General Services' Office of Legal Services has implemented processes that ensure the review of all non-competitive bid and large-scale system integration contracts.

***Legislative Action: None.***

We are unaware of any legislative action implementing this recommendation.

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

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

contract the State also agreed not to replace the Oracle license with substantially similar database licenses for one year from the termination date.

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

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

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

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

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

# CONTRACTORS STATE LICENSE BOARD

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

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

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

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

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

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

### **CSLB:**

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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



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

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

***Agency Action: Pending.***

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

# OFFICE OF CRIMINAL JUSTICE PLANNING

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

REPORT NUMBER 2002-107, OCTOBER 2002

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

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

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

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

*continued on next page*

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

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

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

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

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

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

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

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

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

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

OCJP stated that it had created a formal written policy to use when considering the past performance of an applicant as a factor in its funding decisions. This new policy will be used for those applying for competitive funding under OCJP's January 2003 request for proposal.

In order to address the possible view that the current appeals guidelines are overly strict in terms of the time in which an applicant may file an appeal after receiving a denial notice and the limited information provided to the applicant, OCJP has revised its appeals guidelines. The guidelines will be reviewed by an independent council that hears such appeals at the end of January 2003 and then sent to grant recipients for their input. OCJP stated it hopes to implement the revised guidelines by March 1, 2003.

Finally, OCJP stated that it is looking forward to working with the new domestic violence advisory council to be established after January 1, 2003, and composed of experts from the domestic violence community to develop funding priorities, frame the request for proposals, and solicit

applicants. OCJP also stated that it envisions working with the advisory council to set funding levels for the shelter-based program as a whole and for individual shelters.

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

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

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

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

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

OCJP stated that it has a goal of conducting one technical site visit for a new grant recipient within the first six months of the grant period and one monitoring visit within the three-year grant period. Therefore, at a minimum, every grant recipient will receive a visit (from staff of either OCJP or DHS) at least once every three years. OCJP also stated that it is in the process of prioritizing its monitoring visits based on an internal risk assessment.

OCJP also asserted that it intends to increase coordination among its programs, audits, and monitoring branches to better address grant recipient issues and concerns, as well as to improve documentation and follow-up on grant recipient performance problems and corrective actions taken.

Finally, OCJP states that it has entered into a contract with the Department of Finance's audit unit in order to review audit reports submitted to OCJP by its grant recipients. Consequently, along with increased reviews by OCJP internal audit staff, the backlog of unreviewed audit reports is being reduced. OCJP also intends to work with the SCO and eliminate, if necessary, audit reviews of municipal grant recipients that are duplicative of the SCO's reviews.

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

During the last three years, OCJP's evaluation branch spent \$2.1 million on activities that culminated in evaluations of uneven quality, content, and usefulness. The branch lacks a process that would help it determine what programs would profit most from evaluations, how detailed evaluations should be, what criteria evaluations must satisfy, and, until recently, how to ensure they contain workable recommendations. The branch has been lax in management of its contracts; as a result, it did not include measurable deliverables in one contract and failed to ensure that it received the deliverables contained in others. It also circumvented competitive bidding rules in entering an agreement with a University of California extension school.

To improve its evaluations branch, we recommended that OCJP:

- Develop a planning process to determine what programs would profit most from evaluations, how rigorous evaluations should be, and that it follow its new process

for discussing the relevance and feasibility of proposed recommendations to improve their chances for implementation.

- Develop general criteria establishing what evaluations should accomplish.
- Include measurable deliverables and timelines in its contracts with evaluators and hold evaluators to their contracts.
- Withhold payments to contractors whenever they do not provide established deliverables or when the deliverables are not of the quality expected.
- Ensure that interagency agreements with university campuses comply with state guidelines regarding competitive bidding.

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

OCJP stated that significant efforts have been made to identify and prioritize those evaluations that are mandated, and it is working to ensure that evaluation criteria and requirements are met. OCJP also stated that one of its three program division chiefs has been assigned to oversee evaluation activities, monitor evaluation contracts, and develop evaluation-related policies and processes.

Further, OCJP stated that it has already taken steps to ensure that evaluation contracts, as well as all other OCJP contracts, are legally compliant. Its chief legal counsel now oversees all aspects of OCJP's contracting process, and will ensure that its interagency agreements for evaluation services (as well as all other contracts) contain specific deliverables and reasonable terms and do not circumvent the competitive bidding, civil service, or other requirements.

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

OCJP's method for assigning indirect and personnel costs to the various programs it administers may result in some programs paying the administrative costs for others. Its allocation of indirect costs has been inconsistent, and it has not kept adequate records of its allocation decisions to demonstrate that they were appropriate. OCJP has also failed to require its employees to record their activities when working on multiple programs as required by federal grant guidelines.

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

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

OCJP stated that it has developed a timesheet modeled after those used by other state agencies and is developing procedures to implement the use of the new timesheet throughout OCJP. Pilot testing of the time-reporting system has already begun and OCJP anticipates the system will be fully implemented by June 2003.

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

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

OCJP could provide no documentation of the decision-making process it used to arrive at the \$185,000 funding minimum, such as written input from the shelters stating that the previous minimum amount was insufficient. Furthermore, OCJP provided no indication that it had considered the consequences that raising the minimum funding amount of some shelters by as much as \$30,000 would produce.

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

***OCJP Action: Pending.***

OCJP stated that Senate Bill 1895 provided the authority to create an advisory council effective January 1, 2003, that will be able to recommend specific future funding levels for all shelters in OCJP's domestic violence program, and it is looking forward to working with the council.

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

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

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

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

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

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

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



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

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

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

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

In addition, DHS stated that it had developed and maintains an audit-tracking log to monitor the receipt of audit reports, and has developed guidelines to ensure that audit reports are received on time. Finally, DHS stated that it would meet with OCJP to assess staff resources and develop a system to ensure all domestic violence shelters are visited by either OCJP or DHS at least once per grant cycle.

DHS also stated that it has developed a review tool, which it started using in October 2002 during its initial site visits and a risk-assessment process to prioritize the shelters it will visit first.

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

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

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

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

According to the governor's proposed budget for fiscal year 2003–04, all domestic violence programs administered by OCJP are to be transferred to DHS, subject to legislative approval.

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

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

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

- Align the reporting periods for their progress reports so that shelters do not have to recalculate and summarize the same data for different periods.
- Coordinate technical site visits, monitoring site visits, and audits that they schedule for the same shelters.
- Establish procedures for formally communicating on a regular basis with each other their ideas, concerns, or challenges regarding the shelters.

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

According to the governor's proposed budget for fiscal year 2003–04, all domestic violence programs administered by OCJP are to be transferred to DHS, subject to legislative approval.

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

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

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

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

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

According to the governor's proposed budget for fiscal year 2003–04, all domestic violence programs administered by OCJP are to be transferred to DHS, subject to legislative approval.

***Legislative Action: Unknown.***

We are unaware of any legislative action with regards to this recommendation.

# THE DEPARTMENT OF GENERAL SERVICES

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

REPORT NUMBER 2002-108, DECEMBER 2002

Department of General Services' response as of November 2002

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

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

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

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

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

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

Although units within General Services' Real Estate Services Division (Real Estate Services) and Office of Public Safety Radio Services (Radio Services) do well with certain aspects of estimating costs and fees for capital outlay and radio equipment installation projects, they do not always follow the best practices we identified or their own procedures. Specifically, staff were unable to provide us with documentation to demonstrate how the estimators derived the estimated cost for all line items for 8 of the 10 projects we reviewed. In addition, Radio Services could not always demonstrate that its project estimates received either client or supervisory approval. The lack of client approval for two projects may lead to Radio Services absorbing \$93,000 of the projects' costs. Moreover, these units are not consistently using multiple cost estimating approaches—along with historical data—when preparing estimates and are not conducting end-of-project reviews to evaluate the success of their estimates. We also found that Radio Services had not compared actual results to the estimates it generated using an estimating tool. As a result of these deficiencies, General Services cannot ensure that fees charged to client departments for these services are reasonable and fair. Further, the significant variances we found in project

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

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

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

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

General Services agrees with the elements of best practices identified in our report and is striving to implement processes that include those practices. Specifically, General Services indicates it is taking action to ensure that documentation of assumptions used when creating estimates and documentation of both supervisory and client approval is maintained in the estimate files. In addition, General Services will continue its efforts to implement end-of-project evaluations, to develop a historical database and to develop the information needed to review its estimating tools. General Services stated that it will be able to use additional cost-estimating approaches for its projects once it obtains more historical project information.

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

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

To ensure that the reports General Services uses in setting hourly rates reflect the true projected cost for each unit, we recommended that it require units to include in their cost-recovery proposals the actual, unadjusted, at-cost hourly rate and clearly document the existence of and retain support for any adjustments designed to achieve a desired or recommended hourly rate. Also, to improve its method of allocating overhead and to make the process more objective, Fiscal Services should consider using another method to allocate its overhead costs to other units, such as using an average of two or three years' actual costs per unit.

***General Services' Action: Pending.***

General Services stated that as a part of its annual financial plan process, its executive management team will be provided at-cost rates as well as various other rate scenarios that will impact an operating unit's ability to be financially solvent and avoid rate volatility. In addition, Fiscal Services will take the lead role for ensuring that units document and retain records that identify the basis for those costs that are excluded from hourly rate calculations. Finally, other methods for allocating Fiscal Services' overhead will be considered and presented to the management team.

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

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

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

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

Radio Services indicates that it is implementing procedures to improve the accuracy of its cost accounting system. Further, Radio Services is developing an information technology system that will improve its billing practices and provide more invoice detail to client departments.





# UNIVERSITY OF CALIFORNIA

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## ***New Policies Should Make Career Appointments Available to More Employees and Make Campus Practices More Consistent***

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

*Our review of the University of California's (university) use of casual employees revealed the following:*

- ☒ *Casual employees in the same occupational group as career employees had fewer opportunities for salary increases and received fewer benefits.*
- ☒ *Several factors contributed to the differences among campuses in the use of casual employees, including the extent to which they monitored casual employment.*
- ☒ *Use of casual employees appeared reasonable for jobs with fluctuating or sporadic workloads.*
- ☒ *In other instances, the use of casual employees was not reasonable because the employees were working full-time for several years with a minimal break in service annually, a device used to perpetuate a position's casual status.*

*Finally, we found that casual employment had no uniform pattern of impact with respect to ethnic group or age group.*

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**REPORT NUMBER 2000-130, APRIL 2001**

**University of California's response as of May 2002**

**A**lthough casual employees at the University of California (university) were employed in the same occupational groups as career employees and may have worked the same number of hours for a limited time, they had fewer opportunities for merit salary increases, received significantly fewer employment benefits, and were less likely to keep their jobs during layoffs.

Until recently, the university defined casual employees as nonstudent employees appointed to work either 50 percent or more of full-time for less than a year or less than 50 percent of full-time indefinitely, while it defined career employees as employees expected to work for one year or longer at 50 percent of full-time or more. The university now refers to casual employees as limited-appointment employees and has approved new policies and agreements requiring it to convert to career status those who work more than 1,000 hours in any consecutive 12-month period.

As of October 1999 casual employees represented 9 percent of the university's employees, despite some general university policies that may have restricted its use of casual employees. The extent to which each campus used casual employees ranged from a high of 24 percent (University of California, Los Angeles) to a low of 10 percent (University of California, Davis) of casual employees to total casual and career employees. Several factors contributed to the differences among campuses in the use of casual employees. For example, the campus that had the lowest proportion of casual employees monitored casual employment centrally to a much greater degree than occurred at most other campuses. Another important factor affecting the number of casual employees was the use of outside contractors at some campuses to perform work that casual employees performed at

other campuses. As a result, the number of casual employees on the campuses without these contractors may have appeared disproportionately high.

When campus and department administrators explained their reasons for using casual employees, we found that in some instances the use of casual employees appeared reasonable, but in others it did not. In making this assessment of a department's practices, we did not consider the use of casual positions reasonable when the employees worked 50 percent of full-time or more for over a year. Some kinds of work are well suited to casual employment, and we found many instances in which campuses' use of casual employees was reasonable. For example, various kinds of jobs with fluctuating workloads and jobs that benefit from having short-term, part-time staff who can fill in during peak times were generally reasonable as casual appointments.

On the other hand, we found other instances when the use of casual employees did not appear reasonable. For example, departments at one campus cited several reasons, including the uncertainty of future funding, for using casual employees as staff research associates and laboratory assistants in various research departments. However, we question this justification for using casual employees. Even though the funding may not have been available indefinitely, nothing precluded the university from providing career status to these staff research associates or laboratory assistants. Career status does not guarantee continued employment. We noted that of the 107 casual employees we reviewed in several research departments on one campus, 14 had worked full-time for more than three years, with a minimal break in service annually, a device used to perpetuate a position's casual status. Some of these employees were also working 20 to 50 hours of overtime monthly. Because these employees worked in these positions at more than 50 percent time for an extended period, we think these positions could have been converted to career status even before the new rules were established.

Finally, we also found that casual employment had no uniform pattern of impact with respect to ethnic group or age group.

### **Finding: Some Campuses Did Not Follow University Policies Related to Casual Employee Benefits**

Certain casual employees received benefits that they were not entitled to receive and that others in their position did not because some campus administrators misunderstood university

policy. Furthermore, the Payroll/Personnel System required separate codes to identify the employment type—casual or career—and to identify the package of benefits the employee was eligible to receive. However, the campuses' personnel system did not appear to provide an automated check that compared the two codes and disallowed or flagged an entry that violated university policy. When the university is inconsistent in its treatment of employees, it exposes itself to potential morale problems and questions of fairness. In addition, when campuses provide benefits to casual employees that they are not entitled to receive, they also unnecessarily spend public funds.

To ensure that campuses fully understand the new university policies, we recommended that the Office of the President clarify its policies related to the eligibility of employees for certain benefits. In addition, the Office of the President should install automated checks in the Payroll/Personnel System to disallow or flag entries that violate university policy.

***University Action: Corrective action taken.***

The university believes that it has fully complied with the recommendation to clarify its policies related to the eligibility of employees for certain benefits and to fully inform campuses of these changes. The university reports it clarified its policies by providing training sessions for campus administrators, established an administrative Web site to help campus administrators understand and implement the new policies, and provided articles describing the new policies in issues of the university's human resources publication. Finally, the university also states that it has modified the Payroll/Personnel System and the Corporate Personnel System to comply with the new rules and to allow the Office of the President to monitor campus compliance with changes in temporary employment policies. The university indicates that it continues to refine the data fields and checks needed to flag data entries that are not consistent with university policies. However, the university also states that further work will be required to help ensure that the data captured in management reports is accurate and complete.



# UNIVERSITY OF CALIFORNIA

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## ***Some Campuses and Academic Departments Need to Take Additional Steps to Resolve Gender Disparities Among Professors***

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

*Regarding the University of California (UC) and its hiring of assistant, associate, and full professors:*

- ☑ *Hiring data for the past five years indicate that a significant disparity appears to exist between the proportion of female professors hired and the proportion of female doctorate recipients nationwide.*
  - ☑ *Certain types of decisions made by academic departments effectively reduced the proportion of women in the available labor pool from 46 percent to 33 percent. The UC hired 29 percent female professors during that five-year period.*
  - ☑ *Analyses of the hiring practices used on each UC campus reveal weaknesses such as using search committees that are either all male or predominantly male.*
  - ☑ *Although the starting salaries for female professors averaged from 90 percent to 92 percent of male professors' salaries, more in-depth analyses point out that factors other than gender may be the cause.*
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**REPORT NUMBER 2000-131, MAY 2001**

**University of California's response as of November 2002**

**T**he Joint Legislative Audit Committee requested that we review the University of California's (UC) practices for hiring assistant, associate, and full professors (professors) to determine whether those practices adversely affect employment opportunities for women. A decline in the proportion of newly hired female professors prompted concern about employment opportunities for women, especially in light of UC's expectation that it will need to hire about 7,000 new faculty members over the next 10 years. Specifically, we found:

### **Finding #1: Not all UC campuses fully consider gender parity concerns early in the hiring process.**

It is during the position allocation phase, the first of three steps in the process for hiring UC professors, that departments decide the specific levels at which to hire professors and the specialized fields or subfields of study from which to hire them. The likelihood of obtaining a male or female professor is strongly influenced by a department's decision to fill a position at the more senior levels (e.g., associate or full professor) or from various disciplines or specialized fields of study that tend to be predominantly male.

Our site visits revealed that some campuses are now directing their departments to consider the existing gender mix of their professors during the position allocation phase. For example, in December 2000, the Irvine campus directed its colleges to "devote attention to enhancing the diversity of the faculty" as part of the position allocation phase. Although these overall efforts seem to be steps in the right direction, we believe that additional considerations early in the hiring process are critical if gender disparities in hiring are to be corrected. Because UC professors can have careers that last 30 years or more, failure to fully consider early in the hiring process the effect that level

and field of study can have on the likelihood of hiring a female professor can unnecessarily prolong a department's efforts to address gender disparities.

To avoid inadvertently contributing to gender disparities among professors while still allowing departments to meet their overall missions, we recommended that UC direct academic departments to more fully consider during the position allocation phase of the hiring process how new positions being requested will affect employment opportunities for women overall and the resulting gender parity of its professors, especially those positions above the assistant professor level and those in disciplines or specializations in which women are underutilized. We also recommended that deans review the sufficiency of the departments' considerations of the effects that level and specialization have on gender parity before authorizing departments to proceed further with the process for filling their positions.

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

Campuses have taken steps to at least partially address these two recommendations. For example, the Berkeley campus instructed its deans and departments to review their requests for new faculty for opportunities to improve the likelihood of recruiting women and underrepresented minorities by broadening proposed search areas (i.e., disciplines and areas of specialization) and/or revising the level of the search (e.g., assistant professor). Further, although it did not address its plans concerning disciplines or specializations in which women are underutilized, the Davis campus stated that it established a target for each of its deans to recruit 80 percent of all new positions at the assistant professor or early associate professor levels on a two-year average.

At the systemwide level, UC states that it will continue to monitor implementation of these recommendations through a review of annual campus academic affirmative action plans and periodic meetings with academic affirmative action administrators and academic vice chancellors.

**Finding #2: Not all departments ensure that they use gender-diverse search committees during the hiring process.**

Within the disciplines we reviewed, the search committees for half of the 242 professors hired in fiscal years 1995–96 through 1999–2000 had, on average, either four or five men.

The average size of a search committee was six members. Further, the search committees for 156 new professors—nearly two-thirds of those hired—included either no women or only one woman. Finally, while the searches for 83 new professors had no women on the committees, only nine committees did not have any men. Campus representatives told us that female professors can provide search committees with different perspectives that otherwise might be lacking when evaluating candidates.

To take advantage of the differing perspectives that women can offer in the search for new professors, we recommended that UC avoid using all-male or predominantly male search committees. We also recommended that UC encourage departments to consider, whenever appropriate, participation by female professors from other departments on search committees.

Further, to address the conflict that can result from low numbers of women in some departments and the attempt to avoid all-male or predominantly male search committees, we recommended that UC develop alternatives to its current search committee methods. One alternative that we suggested was that UC should consider whether departments from various campuses are interested in participating in regional or statewide search committees to conduct the preliminary selection of qualified candidates. If insufficient interest exists for this proposal, UC should identify other specific alternatives.

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

In its *Affirmative Action Guidelines for Recruitment and Retention of Faculty*, UC states that each department should make an effort to appoint a search committee that represents a diverse cross-section of faculty. Further, the guidelines state that departments lacking diversity in their own faculty should consider appointing faculty members from outside the department or develop other alternatives to broaden the perspective of the committee.

At the campus level, all campuses appear to be taking steps to avoid all-male or predominantly male search committees. For example, on the San Francisco campus, academic deans and a vice chancellor will review the makeup of search committees and will not approve a committee's membership if it is not sufficiently diverse. Further, UC states that many campuses have implemented procedures for reviewing search committee composition as an alternative to current search committee methods.



**Finding #3: Some departments prepare less detailed search plans to help direct search efforts while some others do not prepare them at all.**

Search committees on some campuses prepare a document called a search plan before beginning a search. This document details the steps the committee will take, including the job announcement and the advertising media that the search committee plans to use. According to a representative from one campus, search plans help eliminate any subjectivity and allow search committees to solidify selection criteria. Not all search committees include the same level of detail in their search plans. For instance, search committees at departments we visited on the Santa Cruz and Riverside campuses include in their search plans the position announcements and the advertising media they plan to use; although they do not identify the selection processes. Moreover, search committees at departments we visited on the Irvine and Los Angeles campuses do not submit written plans before conducting searches. Because the hiring process can be subjective, the lack of an adequate search plan can compromise the integrity of search efforts and the selection process.

To help ensure that searches for professors are properly conducted, we recommended that UC require search committees to prepare written search plans that describe, at a minimum, the advertising channels to be used, the position announcements to be used in advertising, and the criteria and processes to be used to select winning candidates.

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

In its *Affirmative Action Guidelines for Recruitment and Retention of Faculty*, UC states that each department should require search committees to create written search plans that describe, at a minimum, the underutilization and availability of women and minorities in the field, the methods of recruitment and advertising, the position description, and the criteria to be used in selecting candidates. Also, UC states that it will continue to monitor implementation of this recommendation through a review of annual campus academic affirmative action plans and periodic meetings with academic affirmative action administrators and academic vice chancellors.

Further, UC states that all campuses except Los Angeles now require written search plans. The Los Angeles campus is working to develop a requirement for written plans for all searches.

**Finding #4: Some search committees do not use underutilization data to plan searches.**

We found that some search committees use underutilization data in planning their searches, but others do not. To comply with federal affirmative action requirements, each campus prepares an annual report that compares the estimated proportion of women in the applicable labor pool and the proportion of women in the department. It also identifies a target number or percentage of women, called a “goal,” for the department to hire to achieve gender parity. Departments are required to make good-faith efforts to address this goal.

Some search committees receive this underutilization information and use it to plan the outreach efforts they will need to conduct searches. This helps search committees focus their efforts to achieve their hiring goals. However, some departments on campuses we visited, including Riverside and Santa Barbara, are not incorporating underutilization data and related strategies into their written search plans. Without formally considering the underutilization data while planning searches, search committees may not know how much effort they need to make to help address issues related to the lack of gender parity within their departments.

We recommended that UC require search committees to incorporate underutilization data into their search plans, together with strategies to help achieve any departmental recruiting goal.

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

In its *Affirmative Action Guidelines for Recruitment and Retention of Faculty*, UC states that each department should require search committees to create written search plans that describe, at a minimum, the underutilization and availability of women and minorities in the field, the methods of recruitment and advertising, the position description, and the criteria to be used in selecting candidates. Further, UC states that it will continue to monitor implementation of this recommendation through a review of annual campus

academic affirmative action plans and periodic meetings with academic affirmative action administrators and academic vice chancellors.

UC states that every campus has a method for providing search committees with underutilization data. While some campuses incorporate those data into their search plans, others use affirmative action plans to communicate the data. UC also states that every campus has implemented strategies for informing departments of recruiting goals and assisting with recruitment efforts.

**Finding #5: Some search committees do not effectively use underutilization data to assess their success in recruiting women.**

We found that not all search committees compared the estimated proportion of women in the labor pool to the proportion of female applicants to help determine whether outreach efforts were successful. Certain other search committees did not perform such comparisons until well into the search process, increasing the risk that the hiring process could not be stopped or delayed while outreach efforts were supplemented. Performing such comparisons allows search committees to examine and, if necessary, revise their search efforts to secure a more gender-diverse applicant pool.

To help assess the success of the outreach efforts by search committees in recruiting female applicants and in monitoring the inclusiveness of the hiring process, we recommended that UC compare the proportion of women in the total applicant pool to the proportion in the labor pool as soon as possible after departments have received applications. If the proportions are not comparable, UC should consider performing additional outreach to identify a broader applicant pool.

***UC Action: Corrective action taken.***

As part of its *Affirmative Action Guidelines for Recruitment and Retention of Faculty*, UC states that academic administrators may review the gender and race of candidates on the short list. These guidelines also state that if insufficient representation exists, the selection process should be scrutinized to ensure that the selection criteria were properly and consistently applied. If problems are identified, a search committee may either reopen the search to conduct further outreach

or revisit the pool of qualified candidates to create a new short list. UC also states that it will continue to monitor implementation of this recommendation through a review of annual campus academic affirmative action plans and periodic meetings with academic affirmative action administrators and academic vice chancellors.

UC states that every campus has developed a data collection tracking system that will allow a comparison of the proportion of women in the applicant pool to the estimated availability of women in the labor pool so that departments may perform additional outreach to identify a broader pool. For example, on the Davis campus, deans have been instructed to compare the gender and ethnic composition of the applicant pool to the availability pool before candidates are invited to interviews. If problems are identified, the deans have been further directed to take appropriate action, including performing additional outreach. At the San Francisco campus, search committees have been directed to contact the campus's affirmative action office to obtain the data at some point during the recruiting process.

**Finding #6: Outreach efforts of some search committees should be expanded.**

Some search committees have not been successful in their outreach efforts for professor positions. For instance, while women represent 20 percent of the labor pool in the mathematics discipline, women made up only 9 percent of applicants for positions in the mathematics discipline at two of the UC's campuses. Search committees typically rely on outreach tools such as professional journals to advertise positions. Some search committees advertise on Web pages and in media that target potential female applicants. However, when search efforts fail to produce proportionate numbers of female applicants, search committees may need to go beyond the typically used tools. For example, departments might encourage search committee members to personally contact potential applicants at professional meetings, national conferences, and seminars. Additionally, UC's campuses could find ways to collaborate in the outreach efforts. An unsuccessful applicant at one campus may be a natural fit at another because of specialization, research, or teaching interests.

To help increase the number of female applicants, we recommended that UC explore alternative methods of attracting female applicants when outreach methods prove ineffective. Such methods can include expanding efforts to make personal contacts at various functions both off and on campus and identifying ways to collaborate with other campuses in their outreach efforts.

***UC Action: Corrective action taken.***

UC's *Affirmative Action Guidelines for Recruitment and Retention of Faculty* identifies several outreach methods. These methods include advertisements in national publications, personal contacts, mailing lists, professional and academic conferences, and Web sites. UC also states that it will continue to monitor implementation of this recommendation through a review of annual campus academic affirmative action plans and periodic meetings with academic affirmative action administrators and academic vice chancellors.

UC states that every campus is exploring alternative methods for attracting female applicants, not just when traditional recruitment methods are ineffective, but as standard procedures in all faculty searches. The San Diego campus, for example, requires its departments to advertise in at least one national journal relevant to the discipline. The departments often exceed this requirement by posting job notices in more than one major journal or posting notices more than once in the same journal. Department and search committee chairs also meet during the recruiting cycle with affirmative action staff to obtain additional resources such as lists of female or minority doctoral recipients. Recruiting guidelines for the Irvine campus direct search committees to consider placing advertisements in publications and on Web sites targeted to women and minorities, and to consider making personal contact with faculty and administrators at other institutions to identify potential female and minority candidates.

**Finding #7: Some departments allow a single person to decide if candidates should be considered further in the hiring process.**

Some departments rely on only one member of a search committee when reviewing applications to determine which candidates should be considered further. Such a practice increases the risk that the reviewer's own background, experiences, and

biases may unfairly exclude an otherwise qualified individual, regardless of gender. Having at least two members review applications would better ensure that all candidates are fairly considered.

Therefore, we recommended that UC require at least two members of each search committee to review application material submitted by candidates.

***UC Action: Corrective action taken.***

In its *Affirmative Action Guidelines for Recruitment and Retention of Faculty*, UC states that departments should establish procedures for selection that require applications to be read by more than one person to minimize the possibility that qualified candidates may be overlooked. UC also states that it will continue to monitor implementation of this recommendation through a review of annual campus academic affirmative action plans and periodic meetings with academic affirmative action administrators and academic vice chancellors.

UC states that every UC campus reported either a requirement or a practice of having more than one member of each search committee review all applicants for faculty positions. For example, on the Santa Cruz campus, it is a standard practice to have at least two members of each search committee review all applications. Also, on many campuses it is the norm for the entire search committee to review all applications.

**Finding #8: Some departments do not document the reasons candidates were not selected.**

We found that some departments do not prepare documents summarizing the reasons why candidates did not advance in selection processes. Typically, these deselection documents list the gender and ethnicity of an applicant and the reason why the applicant did not advance further in the hiring process; they are an added control to maintain the integrity of the hiring process. Without deselection documents, campuses are less sure that otherwise qualified candidates were not unfairly excluded from the selection process.

To help ensure that otherwise qualified candidates are not unfairly excluded from further consideration during the hiring process, we recommended that UC require search committees to prepare deselection documents that describe the reasons for rejecting candidates. When necessary, deans or department chairs could then review these documents.

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

In its *Affirmative Action Guidelines for Recruitment and Retention of Faculty*, UC states that search committees should prepare written deselection documents that describe the reasons for rejecting candidates. These guidelines also state that deans or department chairs should review these documents. UC also states that it will continue to monitor implementation of this recommendation through a review of annual campus academic affirmative action plans and periodic meetings with academic affirmative action administrators and academic vice chancellors.

UC states that every campus except Los Angeles has reported that it now requires written deselection reports. The Los Angeles campus is reviewing the formats of other campuses' deselection reports and will develop its own report.

**Finding #9: UC's campuses lack a common methodology for calculating the availability of women in the labor pool.**

Each of the UC's nine campuses prepares an annual affirmative action report describing its own benchmarking method, which measures the availability of women in the labor pool. However, lacking a common methodology for calculating the benchmarks, UC cannot compare each campus's relative success at addressing gender parity issues. Consequently, UC cannot use data developed by the campuses to effectively target additional in-depth reviews or improvement efforts at campuses or disciplines furthest from uniform benchmarks.

To better enable it to identify potential gender parity issues across campus and discipline lines, we recommended that UC devise and implement a uniform method for calculating benchmark data. We also recommended that UC centrally collect applicable hiring data, compare the data with its benchmark data, and determine whether departments need to take actions to address gender parity concerns. Finally, we recommended that, when determining the action to be taken, UC should consider developing approaches to be applied across campuses.

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

UC reported to us that it has implemented two of these three recommendations. UC states that it developed a uniform methodology for calculating availability data and distributed reports from that data to all campuses. UC also

states that it collected centrally applicable hiring data and compared the hiring data and the availability data by campus and academic field. UC distributed reports of the comparison to the campuses.



UC did not specifically address the recommendation concerning developing approaches to be applied across campuses.

**Finding #10: Campuses do not uniformly evaluate deans and department chairs on their contributions to affirmative action and diversity.**

Some campuses do not evaluate their deans or department chairs while another does not always include gender parity as a part of the evaluation. Several campuses evaluate their deans or department chairs only once every five years—the interval discussed in UC’s academic personnel manual. However, such long intervals between evaluations mean that deans and department chairs do not receive timely information about their efforts to address gender parity issues. When campuses do not evaluate deans or department chairs, when campuses evaluate deans or department chairs infrequently, or when evaluations do not include efforts to address issues related to the lack of gender parity, those evaluations are rendered ineffective as a tool for helping to address gender parity issues.

To ensure that addressing gender parity concerns remains a priority on campus, we recommended that UC include an assessment of the contributions of deans and department chairs to address issues related to the lack of gender parity as part of their evaluations. We also recommended that UC evaluate all deans and department chairs on their efforts to address gender parity issues more frequently than every five years.

***UC Action: Corrective action taken.***

UC incorporated these recommendations into its *Affirmative Action Guidelines for Recruitment and Retention of Faculty*. Specifically, the guidelines state that each academic administrator should be held accountable for implementation of an effective faculty affirmative action program and should be evaluated for contributions to affirmative action and diversity efforts. The guidelines also state that deans and department chairs should be assessed annually with regard to their efforts to follow affirmative action good practices in faculty hiring. Further, UC states that it will continue to



monitor implementation of these recommendations through a review of annual campus academic affirmative action plans and periodic meetings with academic affirmative action administrators and academic vice chancellors.

UC states that every campus has developed a method for evaluating deans and department chairs on their efforts to address gender equity in faculty hiring either annually or in conjunction with actual hiring efforts. For example, the San Diego campus states that the annual performance evaluations of deans include an assessment of the deans' contributions to diversifying the campus. This campus also includes a diversity component in its reviews of department chairs, which are held more frequently than every five years.

**Finding #11: UC's concept of excellence does not always incorporate the values of gender parity.**

Some departments did not include the concept of gender parity within their definition of excellence. When speaking of the importance of excellence, some departments spoke of it not only in terms of their faculty members' research and teaching, but also in terms of their departments' placement in national ranking systems. Two national ranking systems we reviewed attempt to provide a measure of the quality of the programs. However, because these systems do not consider gender parity of professors in their rankings, departments are not likely to give the gender parity issue as much weight as if it were considered.

To increase the level of excellence, we recommended that UC redefine its concept of excellence to encompass a broader vision—one that recognizes that the full use of a talent pool that includes female professors can promote new ideas, research areas, and productivity. We also recommended that UC consider working with university rating organizations to incorporate gender parity among professors into their definition of excellence.

***UC Action: Corrective action taken.***

UC states that every campus has taken steps to address the importance of diversity and gender equity in the concept of academic excellence. For instance, UC notes that the systemwide Academic Senate Committee on Affirmative Action and Diversity developed a statement entitled *Excellence Requires Diversity: Leading UC Into the 21<sup>st</sup> Century*. This statement articulates the faculty view of why diversity is essential

to the UC's future. Further, UC's president allocated the second phase of his \$6 million commitment to provide additional start-up funding for departments that hire faculty members whose research, service, and teaching commitment will enhance the diversity of the academic community.

Regarding working with rating organizations, UC states that it has engaged in discussions with staff at the *U.S. News and World Report*, which publishes a well-known ranking of universities, about incorporating the values of gender equity and equal opportunity into its ranking system. UC also issued a letter to this journal formally requesting that it incorporate faculty diversity into its national rankings of universities, commenting that such an action would send an important message regarding the value of diversity in education.

**Finding #12: Summary-level salary reviews can help avoid improper salary disparities.**

UC's campuses generally perform some type of detail-level reviews that help ensure that the starting levels and salary steps for new professors are appropriate given their education and experience. While these detailed reviews serve their purpose, they can fail to identify patterns or inconsistencies in starting salaries that would warrant further exploration. We found two campuses at which summary-level reviews were performed. Because campuses and departments have a great deal of flexibility in determining starting salaries for professors, by using summary-level salary reviews in conjunction with the detail-level reviews that already occur, campuses can help ensure that salary disparities between newly hired female and male professors do not go unnoticed or unexplained. Campuses could then investigate further to identify the factors that contributed to the salary differences and determine whether appropriate and consistent decisions were made.

In addition to being useful on each campus, it is beneficial at a systemwide level to make similar comparisons within disciplines across campuses. A salary-review method used by the Irvine campus relies on four variables (degree, age, degree year, and date of hire) as predictors of salary. We have no reason to believe that these predictors would not be valid indicators for such systemwide comparisons.

To help ensure that salary disparities between female and male professors do not go unnoticed or unjustified, UC should periodically perform summary-level salary reviews at a systemwide and campus level to identify patterns indicating whether female professors are typically receiving lower or higher salaries than male professors receive when other salary predictors are the same. When it identifies salary disparities, UC should determine the reasons why the disparities exist and, if necessary, take appropriate action to correct any inequities.

***UC Action: Corrective action taken.***

UC states that it performed the first of its annual summary-level salary reviews of newly hired professors and that the results are consistent with the findings in our audit report. UC states that UCOP will investigate instances of disparities in data broken out by field, share the information with campuses, and work with the campuses to resolve any identifiable areas of disparities based on gender.

Further, UC states that it has asked each campus to develop a career equity review process to address potential salary inequities once they are identified. Each campus has reported on its methodology for addressing faculty salary equity.

**Finding #13: UC should periodically report on its progress in correcting gender disparity issues.**

Given the breadth of the above issues, we recommended that UC report to the Legislature biennially on its progress in addressing gender parity issues in its hiring of professors. The report should include the results of UC's analysis of hiring data relative to a systemwide benchmarking method as well as the efforts it has made relative to the issues described earlier. UC should also include in this report the results of its progress in addressing salary disparities between genders.

***UC Action: Pending.***

UC states that it reported its progress to the chair of the Senate Select Committee on Government Oversight in May and November 2002. It also states that it will send the first of its biennial reports to the Legislature in May 2003.

# LOS ANGELES UNIFIED SCHOOL DISTRICT

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## ***It Has Made Some Progress in Its Reorganization but Has Not Ensured That Every Salary Level It Awards Is Appropriate***

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

*Our review of the Los Angeles Unified School District (LAUSD) revealed that:*

- ☑ *LAUSD has not demonstrated that it has reduced the central office positions identified in its reorganization plan (plan).*
  - ☑ *Local districts do not have the level of authority over their financial resources or instructional programs described in the plan.*
  - ☑ *Certain high-level administrative positions at LAUSD receive salaries that vary widely from similar positions at other school districts.*
  - ☑ *In a few instances, LAUSD determined salary levels without thoroughly documenting the positions' responsibilities.*
  - ☑ *In some cases, LAUSD lacked guidance for how to determine compensation levels and could not provide much documentation detailing how it set salaries.*
  - ☑ *LAUSD has not drafted performance measures for many high-level administrators, and its measures for the general superintendent are often vague.*
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**REPORT NUMBER 2000-125, JULY 2001**

**Los Angeles Unified School District's response as of  
October 2002**

The Joint Legislative Audit Committee requested an audit of the Los Angeles Unified School District's (LAUSD) recent reorganization and its executive and administrative compensation practices. Specifically, we found that:

### **Finding #1: Local districts do not have the level of authority over financial resources or instructional programs as described in the reorganization plan (plan).**

The plan describes the new role of the central office as a service provider and indicates substantial budgetary and instructional decision-making authority would shift to the local districts. However, the local districts have limited authority over their financial resources and the central office retains the authority to develop instructional policies.

We recommended that to avoid raising public expectations that it believes are not realistic, LAUSD should ensure that there is a clear and complete convergence between what it states in public documents it will do and what it subsequently does. Regarding the plan, LAUSD should periodically report to the Board of Education in open meetings both the extent of discretionary resources allocated to the local districts and the extent to which local district superintendents have decision-making authority over instructional matters.



***LAUSD Action: None.***

LAUSD stated in its initial response to our audit that it did not intend for the reorganization plan to be viewed as a firm commitment and strictly followed. Furthermore, it disagrees with our conclusion regarding the extent of authority the local district superintendents have over instruction and discretionary resources. Therefore, LAUSD did not indicate it planned to take the corrective actions we recommended.

**Finding #2: LAUSD has yet to update some job descriptions since its reorganization and has yet to create job descriptions for a few newly created positions.**

In its plan, LAUSD states that nearly all positions are impacted by the current reconstitution of the central office, making it necessary to review all job descriptions. Therefore, we believe it is reasonable to expect to see evidence that LAUSD reviewed each administrative position and either updated its duties or noted that the duties had not changed. However, LAUSD has yet to do so in some instances and a few newly created positions have no existing job descriptions.

We recommended that LAUSD create job descriptions for new positions, or update job descriptions for existing positions when duties change, to ensure that administrators are receiving salaries commensurate with their current job responsibilities.



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

LAUSD stated that since December 2001 its human resources division has studied many certificated positions, revised the class descriptions, and made salary recommendations. Furthermore, noncertificated positions have described duties and responsibilities. However, LAUSD is still in the process of updating some facility-related positions.

**Finding #3: In some cases, LAUSD lacked guidance when determining the compensation of certain high-level administrators and was unable to provide much documentation detailing how it set some of these salaries. Also, for one position, LAUSD used an employment consultant that was not independent of the salary-setting process.**

Salaries of administrators are set by three different groups within LAUSD, depending on whether the administrator holds a certification and on how high the position is in the organizational

structure of the district. One of these groups has established guidelines, while two of these groups lack thorough written procedures for setting salaries. All of these groups relied on several different methods, including conducting compensation studies or salary surveys. Other methods included relying on the recommendations of an employment consultant or determining an offer that would attract a candidate it deemed desirable. For one position, LAUSD relied on the recommendation of a consultant whose fee was a percentage of the salary it recommended, a situation which we believe impairs the consultant's independence.

Regardless of the method used to set salaries, LAUSD was not always able to provide documents demonstrating that it performed the procedures it said it did before setting salaries. This lack of recordkeeping, coupled with the lack of guidance when setting salaries, gives rise to the appearance of subjective decision making regarding certain administrative salaries.

We recommended that LAUSD establish written guidelines for setting salaries and follow established processes for determining administrative compensation. In addition, LAUSD should maintain complete records of its salary determination process, including what methods it followed and what information it used, so that the levels of compensation it awards are supportable. This includes requiring that contractors submit all contract deliverables and retaining these documents in its files. Also, LAUSD should refrain from basing an employment consultant's fees on the salary of the position being filled if the consultant is involved in the salary determination process.



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

LAUSD indicated that it now has a formal process for determining salary levels for both school-based and nonschool-based administrators below the level of assistant superintendent. However, there is no standard process to set salary levels for employees at or above this level. Furthermore, LAUSD indicated that it now maintains records in varying detail of its salary determination process, depending on the complexity of the study. Finally, LAUSD did not respond to our recommendations to require contractors to submit all contract deliverables, but it did state that, in the one instance in which it recently used an employment consultant, it refrained from basing the consultant's fees on the salary of the position.

**Finding #4: LAUSD did not follow a competitive process when obtaining the services of a facilities consultant whose fees totaled \$477,250 over a one-year period.**

While searching for a candidate to permanently fill the vacancy in its chief facilities executive position, LAUSD relied on the services of an outside contractor. However, LAUSD did not advertise the availability of this contract or seek competitive bids.

We recommended that LAUSD advertise the availability of contracts or positions widely and actively, ensuring that interested contractors or administrators are encouraged to submit proposals or applications for consideration.



***LAUSD Action: None.***

LAUSD did not respond to our recommendation.

**Finding #5: LAUSD has yet to create adequate measures to evaluate the job performance for many high-level administrators, and its measures for the general superintendent are in some instances too vague to allow for an objective assessment of the performance of this position. Moreover, the performance measures for the local district superintendents hold these individuals accountable for student achievement even though the central office retains the authority to develop instructional policies that would affect student achievement.**

LAUSD employs many high-level administrators under contracts that refer to performance measures that it has not yet drafted. In addition, for fiscal year 2000–01 each local district superintendent must demonstrate what he or she has done to further the goals of LAUSD in the general areas of reading, mathematics, and the professional development of the teaching staff. However, specific expectations for each of these areas have not been defined. Also, when local district superintendents are accountable for improving student achievement, their level of responsibility may not match their level of authority since the central office controls the development of instructional policies.

Many of the performance measures incorporated into the general superintendent's contract are also too vague to provide a reasonable basis for evaluating his performance. The general superintendent's contract lists six performance measures including addressing student achievement; however, some of these measures have vague deliverables and are open to subjective interpretation.

We recommended that LAUSD develop well-defined performance measures for its general superintendent and certain other administrators that will result in an objective assessment for these positions. It should also develop performance measures for those administrators who are currently without them. When LAUSD establishes measures for evaluating the performance of its personnel, it should ensure that the level of authority is consistent with what the staff is held accountable for. In particular, LAUSD should address the potential current inconsistency over the authority given to the local district superintendents and their responsibility for improving student achievement.



***LAUSD Action: None.***

LAUSD stated in its initial response to our audit its belief that the local district superintendents have sufficient authority over instruction and that it is appropriate to hold them accountable for improved academic performance. Therefore, it did not indicate it planned to take corrective action. Furthermore, LAUSD did not respond to our other recommendation that it develop well-defined performance measures for those administrators currently without them.





# SCHOOL BUS SAFETY II

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## ***State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected***

REPORT NUMBER 2001-120, MARCH 2002

The Commission on State Mandates' response as of September 2002; school district responses as of October and December 2002

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### *Audit Highlights . . .*

*Our review of the School Bus Safety II mandate found that:*

- ☑ *The costs for the mandate are substantially higher than what was initially expected.*
  - ☑ *The costs claimed by seven school districts varied significantly depending upon the approach taken by their consultants.*
  - ☑ *The different approaches appear to result from the lack of clarity in the guidelines adopted by the Commission on State Mandates (commission).*
  - ☑ *Most of the school districts we reviewed lacked sufficient support for the amounts they claimed.*
  - ☑ *The commission could have avoided delays totaling more than 14 months when determining whether a state mandate existed and in developing a cost estimate.*
- 

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits examine the claims under the School Bus Safety II mandate. Specifically, we were asked to review the Commission on State Mandates' (commission) guidelines to determine if they adequately define the mandate's reimbursable activities and provide sufficient guidance for claiming reimbursable costs. In addition to examining any prior reviews of the claims, we were asked to examine a sample of claims to determine if the costs met the criteria for reimbursement. Finally, the audit committee asked us to evaluate the commission's methodology for estimating the future costs of this mandate.

### **Finding #1: The commission's guidance regarding claims reimbursement lacks clarity.**

The guidance issued by the commission does not provide sufficient clarity to ensure that school districts claim reimbursement for mandated activities in an accurate and consistent manner. Instead, the guidance established a broad standard that has allowed a variety of interpretations by school districts as to what costs to claim. The lack of clarity in the guidance appears to be the result of several factors, including the broad language in the statutes from which the guidelines were developed. In addition, the test claim process does not require the claimant to be specific when identifying activities to be reimbursed. Further, the commission's executive director states that the commission, as a quasi-judicial body, is limited in making changes to the guidelines. Finally, the fact that the school districts' interests appear to have been better represented in the process than the State's also may have contributed to the ambiguity on this issue.

We recommended the Legislature amend the parameters and guidelines through legislation to more clearly define activities that are reimbursable and to ensure that those activities reflect what the Legislature intended. The guidelines should clearly delineate between activities that are required under prior law and those that are required under the mandate. To ensure that the State's interests are fully represented in the future, we recommended the commission ensure that all relevant state departments and legislative fiscal committees be provided with the opportunity to provide input on test claims and parameters and guidelines. Further, we recommended the commission follow up with entities that have indicated they would comment, but did not. Finally, we recommended that the commission notify all relevant parties, including legislative fiscal committees, of the decisions made at critical points in the process, such as the test claim statement of decision, the adoption of the parameters and guidelines, and the adoption of the statewide cost estimate.

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

On September 30, 2002, the governor approved Assembly Bill 2781 (Chapter 1167, Statutes of 2002). This new law requires the commission to specify that costs associated with implementation of transportation plans are not reimbursable claims and requires the amended parameters and guidelines to be applied retroactively as well as prospectively.

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

Commission staff implemented new procedures to increase the opportunity for state agencies and legislative staff to participate in the mandates process; notify relevant parties of proposed statements of decision, parameters and guidelines, and statewide cost estimates; and follow up with entities that are late in commenting on claims. For example, in addition to a letter initially inviting state agency participation, commission staff now send a letter notifying all parties of the tentative hearing dates for each test claim. Additionally, they send e-mail notices of release of analyses of test claims, proposed parameters and guidelines, and statewide cost estimates to fiscal and policy committee staff. Further, commission staff contact state agencies, claimants, and other relevant parties when comments are late.

**Finding #2: Most school districts we reviewed lacked sufficient documentation for their costs.**

We found that many school districts did not maintain sufficient documentation to support their claims. In fact, of the more than \$2.3 million total direct costs the seven districts we reviewed submitted for reimbursement in fiscal year 1999–2000, only \$606,000 (26 percent) was traceable to documents that sufficiently quantified the costs. To support the remaining \$1.7 million (74 percent), these school districts relied substantially upon incomplete supporting data. School districts are to follow the parameters and guidelines issued by the State Controller’s Office (Controller) when claiming reimbursement under the mandate. The districts asserted they had sufficient support, yet the documentation we reviewed lacked crucial elements, such as corroborating data, and failed to substantiate the amounts claimed for reimbursement in many instances. In addition, some school districts claimed amounts for time increases to complete school bus routes, yet they failed to maintain corroborating evidence to support these increases. Further, one district based much of the costs it claimed on questionable assumptions and even claimed for activities that appear to be beyond the scope of the mandate. Only San Diego City Unified School District had support for all the \$5,171 in direct costs it claimed. Additionally, San Jose Unified School District had sufficient documentation to support nearly all the \$590,000 in direct costs that it claimed.

School districts should ensure that they have sufficient support for the costs they have claimed. In addition, the commission should work with the Controller, other affected state agencies, and interested parties to make sure the language in the guidelines and the claiming instructions reflects the commission’s intentions as well as the Controller’s expectations regarding supporting documentation.

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

Ceres Unified School District, Dinuba Unified School District, and Fresno Unified School District conducted time studies to support costs associated with the mandate. San Dieguito Union High School District has taken steps to ensure that its claimed activities are supported by sufficient documentation, including ensuring that it properly maintains training records in its computer system. Elk Grove Unified School District states that when the commission comes out with new rules, regulations, and guidelines regarding the mandate, it will follow them.

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

Commission staff are working with the Controller and others to amend existing parameters and guidelines and adopt new parameters and guidelines that reflect its intention and the controller's expectations regarding supporting documentation. A prehearing was set for October 25, 2002, to discuss the Controller's proposed language with state agencies and interested parties. Additionally, new documentation language was to be incorporated into parameters and guidelines and proposed for adoption at the November 21, 2002, commission hearing.

**Finding #3: The commission did not identify the true fiscal impact of the mandate until three years after the law was passed.**

The Legislature was not aware of the magnitude of the fiscal impact of its action when it passed the 1997 law that comprises the majority of the School Bus Safety II mandate. Three different entities that analyzed the 1997 law before its passage believed that it would not be a state mandate and thus the State would not have to reimburse the districts' costs. Further, these entities advised the Legislature that annual costs would be no more than \$1 million, considerably less than the \$67 million in annual costs that the commission is now estimating. This misperception of the likely costs prevailed until January 2001, when the commission finally released a statewide cost estimate. Although the commission is required to follow a deliberate and often time-consuming process when determining whether a test claim is a state mandate and adopting a statewide cost estimate, it appears that it could have avoided a delay of more than 14 months. Consequently, the Legislature did not have the information necessary to act promptly to resolve the issues of possible concern previously discussed in this report. Finally, commission staff believe that waiting for actual reimbursement claims reported to the Controller and using this data to estimate statewide costs for the mandate results in more accurate estimates. However, commission staff have not sought changes to the regulations to include sufficient time for waiting for the claim data.

We recommended the commission ensure that it carries out its process for deciding test claims, approving parameters and guidelines, and developing the statewide cost estimate for mandates in as timely a manner as possible. If the commission believes it necessary to use actual claims data when developing

the statewide cost estimate, it should consider seeking regulatory changes to the timeline to include the time necessary to obtain the data from the Controller.

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

Commission staff implemented new procedures to ensure that it carries out its process in as timely a manner as possible. Specifically, they now plan to propose statewide cost estimates for adoption approximately one month after it receives initial reimbursement claims data from the Controller. They also plan to close the record of the claim and start its staff analysis if claimant responses are not submitted timely. Claimants who choose to rebut state agency positions at a later time may provide rebuttal comments to the draft staff analysis.

Further, commission staff are also reviewing the current process for developing cost estimates and have taken several actions. They requested the Controller to collect data on specific claims regarding the difference between the statewide cost estimate and the amounts actually paid on the claims. Commission staff plan to analyze this data to determine if it can develop more accurate statewide cost estimates and will revise the commission's regulations to reflect any new processes.



# LOS ANGELES UNIFIED SCHOOL DISTRICT

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## ***Outdated, Scarce Textbooks at Some Schools Appear to Have a Lesser Effect on Academic Performance Than Other Factors, but the District Should Improve Its Management of Textbook Purchasing and Inventory***

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

*Our review of the Los Angeles Unified School District (LAUSD) concludes that:*

- ☑ *Although we found more classes in low-performing schools that did not have enough textbooks for each student, we cannot conclude that the higher prevalence of textbook shortages has a direct relation to their school performance.*
  - ☑ *Factors such as the number of credentialed teachers, the level of parents' education, and students' transiency and socioeconomic status do appear to affect school performance.*
  - ☑ *LAUSD does not always spend its restricted textbook and other instructional materials funds appropriately, and it spends, on average, less per student than other large districts in the State for these resources.*
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REPORT NUMBER 2001-124, JUNE 2002

Los Angeles Unified School District's and the California Department of Education's responses as of December 2002

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to determine whether Los Angeles Unified School District's (LAUSD) program and policies regarding textbooks and other instructional materials result in a disparity in the quantity and quality of textbooks for a sample of high- and low-performing schools. The audit committee also requested that we do the following:

- Use our sample to determine if a correlation exists between demographic data, such as socioeconomic status and race, and the quantity and quality of the textbooks used by LAUSD schools.
- Identify funding sources that are available and those LAUSD uses to purchase textbooks and other instructional materials, and identify the total amount LAUSD spent on textbooks and other instructional materials for the past two years, review its process for allocating funds, and assess the amounts actually allocated to the schools in our sample.
- Compare LAUSD's average amount spent per student over the past two years for textbooks and other instructional materials to the amount spent by a representative sampling of school districts and the statewide average for all school districts.



- Determine whether publishers are providing free instructional materials to the same extent to all school districts and review LAUSD's conflict-of-interest policy regarding the purchase of textbooks and other instructional materials to determine if it is consistent with the requirements of state law and whether LAUSD personnel follow the policy.

Although our audit of 16 LAUSD schools did not reveal any significant disparities in textbook quality and quantity among high- and low-performing schools, we did find students in both types of schools using outdated textbooks and that did not have a core subject textbook available for use in the classroom and at home. Moreover, other factors, such as teacher credentialing and student transiency, appear to have a greater impact on student academic performance. We also found that LAUSD can improve its management of textbook purchasing and inventories. Specifically, we found:

**Finding #1: Students do not always have sufficient textbooks.**

LAUSD policy requires that each student have a textbook in the core subjects for use in the classroom and at home. However, we found widespread use by LAUSD schools of textbooks restricted to the classroom and not available for students to take home, commonly referred to as class sets. Until LAUSD addresses its textbook shortages, it cannot ensure that each student in classes without textbooks receive the same instruction as their peers in classes that have textbooks for each student.

We recommended that to make sure that each student has the best opportunity to achieve academically, LAUSD enforce its existing policy.

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

LAUSD reports that a checklist has been developed and that it will be used by textbook services staff to review the status of school sites in relation to numbers of textbooks available. LAUSD assigned staff to ensure each school remains current with the policy of a textbook for each student in the core subject area.

**Finding #2: LAUSD is not fully complying with state law requiring school districts to annually certify that students have sufficient textbooks and/or instructional materials.**

State law requires school districts to hold a public hearing and to determine through a resolution, whether each student has or will have before the end of the fiscal year, in each subject area, sufficient textbooks and/or instructional materials that are consistent with the content and cycles of the curriculum framework adopted by the State Board of Education (state board). However, LAUSD's fiscal year 2000–01 certification was incomplete because LAUSD does not require its schools to certify for each subject adopted by the state board. Rather LAUSD has only required its schools to certify that they have sufficient textbooks in subjects that are consistent with the state board's most recent adoption cycle. Until it requires schools to certify in accordance with state law, LAUSD will be out of compliance with the law and will be unable to ensure that its students have sufficient textbooks.

We recommended that LAUSD require its schools to certify annually that each student has, or will have prior to the end of that fiscal year, in each subject area, sufficient textbooks and/or instructional materials that are consistent with the content and standards of the curriculum framework adopted by the state board.

***LAUSD Action: Pending.***

LAUSD stated that new procedures are under development that will require all schools to certify that they have sufficient materials in all subject areas falling under the content and curriculum frameworks adopted by the State. All subject area certifications are scheduled to begin in January 2003.

**Finding #3: LAUSD's goal of a six to one student-to-computer ratio is inconsistent with its consultant's recommendation and best practices.**

In May 2000, LAUSD adopted a five-year instructional technology plan, which includes a goal of moving toward a student-to-computer ratio of six to one. However, this goal is inconsistent with a recommendation made by its consultant in 1998 that LAUSD adopt the maximum student-to-computer ratio for ideal learning of five to one. A June 2001 report issued by the

Chief Executive Officer Forum on Education Technology also indicates that a reasonable goal for the number of students per instructional computer is five or less.

We recommended that LAUSD consider adopting a student-to-computer ratio of five to one.



***LAUSD Action: None.***

LAUSD stated that it has no plans to move toward a student-to-computer ratio of 5-to-1, but does plan to continue to move toward a 6-to-1 ratio.

**Finding #4: LAUSD's low-performing schools have fewer teachers that possess a basic teaching credential than high-performing schools.**

Our analysis of LAUSD data for about 560 elementary, middle, and high schools for fiscal years 1999–2000 and 2000–01 revealed that LAUSD's low-performing schools generally have fewer fully credentialed teachers than its high-performing schools. A November 1997 report by the California Commission on Teacher Credentialing (commission) states that the quality of teachers is the single most important determinant of student success and achievement in school. As part of its Teaching As a Priority Program, LAUSD plans to (1) increase the number of teachers in its low-performing schools who possess basic credentials by providing stipends directly to teachers assigned or transferring to Academic Performance Index rank-1 schools and (2) issue recruitment and retention grants to the local districts so that they can tailor their efforts to local conditions. LAUSD also plans to contract with an external evaluator to measure the effectiveness of its efforts in recruiting and retaining credentialed teachers in LAUSD's low-performing schools using data collected over a three-year period.

We recommended that to increase the number of teachers who possess basic credentials in its low-performing schools, LAUSD continue its current recruitment and retention efforts and expand those efforts to include all financial incentives offered by the State or federal government. Further, LAUSD should review

the recommendations of its outside evaluator and implement those recommendations that will further increase its ability to recruit and retain teachers in low-performing schools.

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

LAUSD reported that it is in the process of implementing a fast track process for considering credentialed teacher applications and that it has created a new on-line teacher application. LAUSD also stated that it is developing a Teacher Quality Strategic Plan and that it will continue to work with universities and colleges to increase the number of credentialed teachers assigned to LAUSD. Moreover, LAUSD has ongoing efforts to expand the number of teacher recruits from Teach for America and the New Teacher Project and to identify other sources for support. Finally, LAUSD reported that in March 2002 two external evaluators made recommendations on ways to improve its human resource and recruitment practices; however, LAUSD did not provide specifics on its intent to implement these recommendations.

**Finding #5: LAUSD does not always spend restricted textbook funds appropriately.**

LAUSD allocated a total of \$92 million in restricted Instructional Materials Fund (IMF) and Schiff-Bustamante Standards-Based Instructional Materials Program (Schiff-Bustamante) funds in fiscal year 2000–01 to its elementary, middle, and high schools. According to LAUSD accounting records, schools inappropriately spent \$16.2 million of these funds to purchase other books that are not part of the core curriculum, such as library books or test preparation workbooks and instructional materials. Further, our review of a sample of eight invoices found that school staff are not always using the correct accounting codes, which suggests that LAUSD cannot ensure that funds designated for purchasing textbooks are spent appropriately.

We recommended that LAUSD provide training to school accounting staff to ensure that they are aware of the proper accounting for textbook funds and conduct periodic monitoring of the use of state-restricted textbook and IMFs to ensure the uses are appropriate.

***LAUSD Action: Corrective action taken.***

LAUSD stated that it has provided training to the Local District Business Managers on the accounting for and use of state textbook funding and that these managers will conduct periodic reviews of textbook purchases. Additionally, they are working with local school site staff to ensure compliance with appropriate expenditure guidelines. Further, LAUSD will send letters to publishers regarding its procurement procedures, has listed terms and conditions on its purchase orders, and has linked commodity codes to textbooks so that purchases are stopped during the ordering process if inappropriate materials are being ordered.

**Finding #6: Publishers of textbooks and instructional materials are not treating all schools fairly.**

State law requires publishers to provide any instructional materials free of charge to school districts in California to the same extent as they provide them to any school district nationwide. The California Department of Education (department) refers to this law as the “most-favored-nations clause.” Some publishers are not equitably providing free instructional materials (commonly referred to as gratis items) to different schools within LAUSD, as state law requires. For example, during a review of only 15 invoices, we found two cases where schools did not receive the same gratis items from the same publisher for the same textbooks. In total, we found that four schools were shortchanged gratis items worth more than \$60,000. Unfortunately, the disparate treatment shown in our examples, as well as in any other cases that may exist, would most likely not be detected because neither LAUSD nor the State conducts any monitoring to ensure that publishers comply with the most-favored-nations clause.

To ensure that publishers are treating all California schools equitably, we recommended that the department modify its regulations or seek legislation, if necessary, to require publishers and manufacturers to report, at a minimum, all offers of free instructional materials for Kindergarten through grade 12 within 30 working days of the effective date of the offer. The department should also maintain a comprehensive Web site that contains this information and require publishers to report to the department in a standard electronic format. Further, the department should establish a hot line to receive complaints regarding unfair treatment and instruct school districts to

contact the hot line if they receive textbook prices or free materials that differ from those posted on the department's Web site. Finally, when necessary, the department should pursue cost recovery for any violations of the most-favored-nations clause and work with school districts to identify and remove any other obstacles that prevent them from effectively monitoring the most-favored-nations clause.

To ensure that its schools are treated fairly by publishers, we recommended that LAUSD ensure that school and local district staff involved in purchasing textbooks and other instructional materials are aware of the state law that requires publishers to treat schools equitably and have access to current publisher price and gratis item lists when placing orders. In addition, LAUSD should modify its accounting system to include standard book numbers and should collect damages from the publishers identified in our report for noncompliance with the most-favored-nations clause. Moreover, LAUSD should conduct periodic monitoring of the prices and gratis items publishers offer its schools for similar purchases and pursue cost recovery for any exceptions found. Finally, LAUSD should work with the department to identify and remove any other obstacles that prevent it from effectively monitoring the most-favored-nations clause.

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

LAUSD reported that it has taken several steps to increase awareness of the most-favored-nations clause. For example, it has provided training to Local District Business Managers, revised its price lists and order forms, and sent letters to publishers requiring them to provide current information to schools at the time of order. LAUSD also reported that it will consider including ISBN numbers during the development of its new financial systems that it plans to implement over the next five years. LAUSD negotiations with the publishers identified in our report are continuing and Prentice Hall has provided more than \$300,000 thus far in gratis items to schools that purchased mathematics materials. LAUSD reports that its Textbook Services Office, with the support of its general counsel and the department, are pursuing all exceptions found for cost recovery. LAUSD reported that it is participating in the department's Instructional Material Advisory Group on free and gratis items and is reporting violations to the State. To monitor publisher compliance with the most-favored-nations clause, LAUSD is implementing a process to periodically review a random sample of invoices.



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

The department stated that its Curriculum Frameworks and Instructional Resources Division must sustain cuts in funding and its proposals to implement our recommendations are based on those objectives that can be met within the fiscal constraints. Although the department did not address modifying its regulations, it did report that it now requires publishers to provide a link to their instructional material Web sites. In addition, the department is in the process of developing an on-line complaint form, which will include contact telephone numbers to education program consultants who will investigate and resolve complaints. The department reported that it is seeking a legal opinion to determine whether it has the authority to pursue cost recovery for violations of the most-favored-nations clause. Finally, the department reports that it has met with school districts and plans to convene a focus group in early 2003 to discuss strategies to improve the enforcement of the most-favored-nations clause.

**Finding #7: Central administration of textbook purchases might resolve several shortcomings.**

LAUSD might be able to resolve many of the shortcomings in its process for ordering textbooks if it centralizes this function. Specifically, LAUSD could reduce inappropriate charges against restricted state textbook funds, improve its payment record and ability to do business with preferred vendors, and ensure that schools receive the same gratis items from publishers.

We recommended that LAUSD consider centralizing its textbook-purchasing function at LAUSD or the local district level.

***LAUSD Action: Pending.***

LAUSD is considering a modified textbook purchasing process for 2003 in which the Local District Business Managers will oversee purchasing and ensure equitable treatment from publishers, using guidelines established by its Textbook Services Office.

**Finding #8: LAUSD's textbook inventory system is not fully implemented.**

Between May 1999 and August 2000, LAUSD purchased, for almost \$2 million, an inventory system designed to monitor and account for textbooks and maintain data on textbook damage. Despite LAUSD's considerable cost and effort to help schools implement the inventory system, we found that the system is not widely used. Ensuring that schools implement the system would enable LAUSD to monitor and account for its textbooks adequately so that each student has a textbook for all subjects. LAUSD would also be able to begin complying with a state law requiring it to publicly report information regarding the quality and currency of textbooks and instructional materials so that parents can make meaningful comparisons between public schools before enrolling their children. Although LAUSD's Business, Finance, Audit, and Technology Committee lists the development of a centralized textbook inventory system as one of its technology projects, it reported in May 2002 that this project is not fully funded.

LAUSD should proceed with its plans to develop a centralized textbook inventory system. The system should include all texts and other instructional materials at each school and include ongoing standardized training and both implementation and technical support.

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

LAUSD told us that it is proceeding with the implementation of a centralized inventory system and that three additional staff have been assigned to aid these efforts. LAUSD is also developing a plan to support implementation efforts at the senior and middle schools. In addition, a temporary web-based central inventory system is in place and is being populated with inventory data until its new student information system, which will include textbook inventory data, is put in place.

**Finding #9: LAUSD can improve the way it holds students and parents accountable for lost or damaged textbooks.**

LAUSD's inadequate system for tracking textbooks also diminishes the ability of some schools to ensure that students or their parents are accountable for lost or damaged textbooks. In addition, during our testing of 16 schools, we found



varying degrees of compliance with LAUSD's policy for student accountability. Consequently, schools may not be recovering as many textbooks or as much money as they could.

LAUSD should make sure that schools and local district staff are aware of and are complying with its student accountability policy for lost or damaged textbooks, including the maintenance of an accounting or inventory system that clearly identifies the student and the type of school property issued to the student.

***LAUSD Action: Pending.***

LAUSD reported that it is developing an accountability process to reduce textbook loss and damage rates. LAUSD will provide its local district staff with training and will then work with schools on this issue. Baseline loss rates have been determined so that it can measure progress at the middle and senior high schools each spring.

**Finding #10: LAUSD can strengthen its conflict-of-interest and disclosure code to include staff involved in textbook-purchasing decisions.**

LAUSD can further improve its controls over textbook purchasing by modifying its conflict-of-interest and disclosure code to require principals and members of textbook evaluation committees to complete an annual disclosure statement that would reveal any potential conflicts with textbook publishers or manufacturers. LAUSD's ethics officer told us that he expects to submit the most recently proposed revisions to the disclosure code for approval by the end of June 2002, which will include adding principals to the designated employee list. In addition, he told us that future proposals would include the results of LAUSD's continuous review of other district and school positions and their changing responsibilities to see if it is appropriate to add them to the list of designated positions. By strengthening its code, LAUSD can further reduce the risk of bias or the appearance of impropriety in the textbook adoption and purchasing process.

We recommended that LAUSD revise its conflict-of-interest and disclosure code to include principals and textbook evaluation committee members in its list of designated positions. In addition, LAUSD should continue its plan to review other district and school positions for inclusion in the code as designated positions.

***LAUSD Action: Pending.***

LAUSD reported that it submitted a revised conflict of interest and disclosure code (code), which included principals in its list of designated positions, to the state board for approval. However, the revisions the state board adopted did not include the portion of the code related to conflict of interest. This portion of the code is being reviewed by the County Office of Education, the entity with the ultimate authority on who has to file. LAUSD did not address whether the code includes textbook committee members in its list of designated positions.



# UNIVERSITY OF CALIFORNIA

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## ***Its Partnership Agreement Could Be Improved to Increase Its Accountability for State Funding***

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

*Our review of the University of California's (university) partnership agreement revealed the following:*

- ☑ *Of 22 objectives included in the agreement, 9 contain outcomes that identified quantifiable and clear targets to measure improved performance, and 13 do not. Thus, the university's ability to demonstrate its success in using state funds to achieve the objectives is limited.*
  - ☑ *The university's expenditures for support salaries increased at a faster rate than its expenditures for academic staff salaries within instruction, research, and public service between 1997 and 2001—two years before and three years after the partnership agreement went into effect.*
  - ☑ *Certain factors have an impact on the 4.8 primary course-to-faculty ratio the university agreed to maintain as part of the partnership agreement. For example, we found that 13 percent of the primary courses taught by regular-rank faculty had enrollments of two students or fewer.*
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### **REPORT NUMBER 2001-130, JULY 2002**

#### **The University of California's response as of September 2002**

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits conduct a comprehensive audit of the University of California's (university) performance under the partnership agreement. As part of the audit, the audit committee asked that we evaluate the effectiveness of the methods the university has established to allocate the increased state funding it receives and the procedures it has developed to measure campuses' performance in meeting the goals of the partnership agreement. In addition, it requested that we compare university expenditures before and after the partnership agreement to determine how the university has allocated and expended its increased state funding. Further, we were to determine whether the university has implemented a state-supported summer term with services similar to the regular academic year, and we were to analyze the university's annual Undergraduate Instruction and Faculty Teaching Activities report (instructional report) for the past three years and present conclusions reached on any trends we identified.

#### **Finding #1: The university cannot fully measure its accomplishments because the partnership agreement does not always establish measurable and clear targets.**

In May 2000, the university and the governor entered into a four-year partnership agreement encompassing fiscal years 1999–2000 through 2002–03. The overall intent of the agreement was to provide the university with funding stability in exchange for its progress toward meeting certain objectives included in the partnership agreement. As a result, although the Legislature is not a party to the partnership agreement, the Legislature and the governor appropriated additional state funds during the first two years of the partnership agreement that they expected the university to use, in combination with

existing resources provided by the State, to accomplish objectives identified in the partnership agreement. However, although the partnership agreement contains clear and measurable targets for some of the objectives it outlines, it does not contain such targets for many others. Therefore, the university's ability to demonstrate its success in using state funds to achieve the partnership agreement's objectives is limited.

Specifically, in our review of the 22 objectives specified in the partnership agreement, we found that only 9 contain outcomes that identify quantifiable and clear targets to measure improved performance. For the other 13 objectives, the partnership agreement does not identify clear and measurable targets, even when the objectives lend themselves to the establishment of such targets. For example, 1 objective states that beginning in 2001, the university should increase the percentage of students from low-participating high schools who enroll in the university. A target for this objective might identify a specific percentage and establish a deadline for the university to reach it, while stating that the university could revise these goals as circumstance warranted. However, the agreement contains no such target.

We recommended that the university propose establishing clear and measurable targets when preparing future partnership agreements. These targets should allow the university to better assess its success in meeting the objectives of the partnership agreement. In addition, if the university is concerned that it will be expected to meet a measurable target when it has not received the related funds or when factors outside its control impede its progress, it should propose that as circumstances change it can revise the targets.

We also recommended that the university confer with the governor and the Legislature to determine whether having the Legislature provide input on objectives and measurable targets for future partnership agreements might be beneficial.

***University Action: Pending.***

The university indicated that the recommendations relating to future partnership agreements would be a matter of negotiation with the governor.

**Finding #2: The university has spent more of its increased state funding on support staff than on academic staff.**

Although the university's primary mission is to teach and conduct research in a wide range of disciplines and to provide public services, it increased its expenditures for support staff salaries made out of its general operating funds at a greater rate than it increased its expenditures for academic staff salaries within instruction, research, and public service between 1997 and 2001. Only 44 percent of its increase in salary expenditures during this time related to these academic salaries, while 56 percent related to support staff salaries. Moreover, the proportion of employees that the university hired in certain support classifications using general operating funds over the five-year period was much greater than those it hired in certain academic positions, despite its nearly 13 percent growth in enrollment. The majority of the increases in the university's expenditures occurred in five job classifications, four of which were support classifications. The number of full-time equivalent (FTE) professorial-tenure employees at the university grew by 504, or 10 percent, while the number of its FTEs within advising services increased by 532, or 59 percent, and the number of its FTEs within fiscal, management, and staff services increased by 2,075, or 43 percent.

The hiring of both academic and support staff may have contributed to achieving the partnership agreement objectives, and the university's hiring decisions may have appropriately reflected its needs. However, because the partnership agreement does not contain objectives or measurable targets that identify the areas in which the university believes growth in positions is necessary, the Legislature and the governor may not be able to evaluate whether the university's decisions reflect the intent of the agreement. The addition of such targets to the partnership agreement would increase the university's accountability for its use of state funds and would enable both the State and the university to better monitor the proportion of increased funding spent on academic and support salaries.

We recommended that the university confer with the governor and the Legislature to determine whether it would be beneficial to establish targets to evaluate how the growth in academic and support positions and spending are consistent with the priorities of the partnership agreement. For example, the university could establish targets that address the growth and positions it believes are needed in such categories as professorial-tenure faculty, other faculty, fiscal staff, clerical staff, and managers to meet

the objectives of the partnership agreement. In addition, the university should confer with the governor and the Legislature to determine whether it is beneficial for the university to report on the actual growth that has occurred compared to the targets.

***University Action: Pending.***

As indicated previously, the university noted that the recommendations relating to future partnership agreements would be a matter of negotiation with the governor.

**Finding #3: Two factors have an impact on the primary course-to-faculty ratio.**

The university compiles certain ratios involving the teaching activities of regular-rank faculty in its annual instructional report, which responds to inquiries made by the Legislature and also addresses one of the objectives included in the partnership agreement. According to that objective, the university in effect agrees to maintain an average workload of 4.8 primary courses per faculty FTE per year. The university defines primary course as a regularly scheduled, unit-bearing course usually labeled as a lecture or seminar. The university's instructional report states that for academic year 1999–2000, the university's primary course-to-faculty ratio was 4.9, exceeding the agreement's requirement.

However, two factors have an impact on the primary course-to-faculty ratio. First, our analysis shows that one- and two-student primary courses represented 0.7 of the university's 4.9 ratio in academic year 1999–2000. Although no requirement exists regarding the minimum number of students in a primary course, having a significant number of small-enrollment primary courses could affect a student's ability to graduate in four years. Second, because Berkeley's faculty apparently teach more primary courses than the faculty at any other campuses when Berkeley's data are converted from a semester to a quarter basis, the higher number of courses taught by Berkeley's faculty affects the university-wide ratio. However, in the instructional report, the university does not discuss the impact of Berkeley's faculty teaching more primary courses.

To ensure that the Legislature and the governor have a complete understanding of the factors influencing the primary course-to-faculty ratio included in the instructional report, we recommended that the university disclose in its instructional report the workload of its regular-rank faculty by the number of students

enrolled in courses. In addition, it should disclose that Berkeley's faculty teach more primary courses on a quarter basis than the faculty of other campuses and should communicate the impact that Berkeley's data has on the university-wide ratio.

***University Action: Pending.***

The university's response did not address whether it plans to disclose in its instructional report the workload of its regular-rank faculty by the number of students enrolled in courses. However, the university indicated that the president has appointed a Universitywide Task Force on Faculty Instructional Activities (task force) to address several of our recommendations including describing the impact of Berkeley's data on the universitywide ratio.

**Finding #4: The campuses could not demonstrate that they correctly classified many of the one- to two-student primary courses we reviewed.**

Our analysis of a sample of the one- to two-student courses offered by the university in academic year 1999–2000 found that the campuses were unable to demonstrate that they had correctly classified 33 percent of them as primary courses. As discussed previously, the university defines primary courses as a regularly scheduled, unit-bearing course usually labeled as a lecture or seminar. On the other hand, independent study course is defined as a unit-bearing activity for which students receive credit toward their degree, but it is not regularly included in the schedule of courses and usually focuses on independent study or special projects by arrangement between a student and faculty member. Seminars and lectures typically have higher enrollments, whereas independent study courses involve one student or a small group of students. The university calculated the primary course-to-faculty ratio by dividing the total number of primary courses by the number of regular-rank FTE faculty. Therefore, if the campuses incorrectly classify primary courses as independent study courses or vice versa, it affects the accuracy of the ratio.

Although nothing precludes the university from providing primary courses with enrollments of only one- to two-students, we focused our review on these courses because we believed these courses were likely to have the highest risk of misclassification because independent study courses generally have low enrollments. We reviewed 240 primary courses with enrollments of only one



to two students at the eight campuses that are included in the university's instructional report. We found that the campuses were unable to provide sufficient support to demonstrate that they correctly classified 79, or 33 percent, of the 240 courses in our sample.

When we asked the university whether it offers guidance to the campuses or verifies the data used in the instructional report, the director of policy analysis responded that the university annually provides instructions and definitions for the campuses' uses in classifying courses. The director of policy analysis also stated that the university trusts the campuses to provide accurate information and does not verify the data included in the tables. However, we found the guidance the university provides to the campuses to be very general and subject to interpretation.

We recommended that the university perform the following actions:

- Clarify the definitions of primary course and independent study course in the instructions it provides to the campuses.
- Ensure that the campuses consistently interpret the definitions of primary course and independent study course by periodically reviewing the campuses' data for accuracy and consistency.
- Review more closely the existing classifications of courses and make corrections where appropriate. This review should include, but not be limited to, primary courses with low enrollments.

***University Action: Pending.***

As indicated previously, the university stated that its president appointed a task force to address several of our recommendations. The task force is to address our recommendations regarding clarifying the definitions of primary courses and independent study, ensuring that campuses consistently interpret those definitions, and reviewing the existing classifications of courses.

**Finding #5: The instructional report does not address the workload of non-regular-rank faculty and miscellaneous instructors.**

Non-regular-rank faculty and miscellaneous instructors—adjunct professors, lecturers, teaching assistants, retired faculty, and others—teach a significant number of the university’s primary and independent study courses. However, the partnership agreement does not address the workload ratios for non-regular-rank faculty and miscellaneous instructors, and the university does not address these staff in its workload-by-FTE table in the instructional report. We found that non-regular-rank faculty teach 30 percent of all primary courses and have a primary course-to-instructor ratio of 8.5. The miscellaneous instructors teach 16 percent of the primary courses, but we were unable to determine their workload ratio because the university’s system was not designed to capture certain data used to calculate the ratio.

In light of the partnership agreement’s objective of graduating students in four years or less, it would seem appropriate for the university to also provide the Legislature and the governor with information regarding the workload ratio for all of its instructors, not just its regular-rank faculty. In fact, the partnership agreement could be expanded to include objectives and measurable targets that specifically address the workload of these staff. The Legislature and the governor would then have a more complete picture of the workload of all instructors and could more appropriately evaluate that workload to determine whether fluctuations occur that may affect the ability of students to enroll in the classes they need to graduate.

We recommended that the university propose expanding future partnership agreements to include objectives and measurable targets that address workload ratios and course enrollment levels for all regular- and non-regular-rank faculty and miscellaneous instructors. Additionally, the university should disclose in its instructional report the course-to-faculty ratio for non-regular-rank faculty and the workload ratios for miscellaneous instructors. Similar to our recommendation for regular-rank faculty, the university should also disclose non-regular-rank faculty and miscellaneous instructor workloads by the number of students enrolled in courses.

Finally, to enable it to calculate and report the workload for miscellaneous instructors, the university should develop a method to capture the FTE data related to these instructors.

***University Action: Pending.***

As indicated previously, the university stated that the recommendations relating to future partnership agreements would be a matter of negotiation with the governor. Currently, however, the university reported that it is examining ways to capture accurately the FTE associated with the non-regular-rank faculty and miscellaneous instructors. The university plans to include information about the teaching activities on the non-regular-rank faculty in its next instructional report. However, it did not address whether it plans to disclose non-regular-rank faculty and miscellaneous instructor workloads by the number of students enrolled in courses.

# CALIFORNIA'S CHARTER SCHOOLS

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## ***Oversight at All Levels Could Be Stronger to Ensure Charter Schools' Accountability***

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

*Oversight of charter schools at all levels could be stronger to ensure schools' accountability. Specifically:*

- ☑ *The four chartering entities we reviewed do not ensure that their charter schools operate in a manner consistent with their charters.*
  - ☑ *These chartering entities' fiscal monitoring of their charter schools is also weak.*
  - ☑ *Some charter schools assess their educational programs against their charters' measurable student outcomes, but others do not.*
  - ☑ *The Department of Education (department) could, but does not target its resources toward identifying and addressing charter schools' potential academic and fiscal deficiencies.*
  - ☑ *Finally, although two new statutes attempt to add accountability, without the chartering entities and department increasing their commitment to monitoring, these new laws may not be as effective as they could be.*
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### **REPORT NUMBER 2002-104, NOVEMBER 2002**

#### **Chartering entities' and the California Department of Education's responses as of November 2002**

The California Legislature passed the Charter Schools Act of 1992 (Act) to provide opportunities for communities to establish and operate schools independently of the existing school district structure, including many of the laws that school districts are subject to. The Legislature intended charter schools to increase innovation and learning opportunities while being accountable for achieving measurable student outcomes. Before a charter school can open, a chartering entity must approve a petition from those seeking to establish the school. Under the Act, three types of entities—a school district, a county board of education, and the State Board of Education—have the authority to approve petitions for charter schools. As of March 2002, there were 360 charter schools serving approximately 131,000 students throughout California. More than 70 percent of the agencies chartering those schools have only one charter school. The Joint Legislative Audit Committee requested that we conduct a comprehensive audit of California's charter schools. We assessed the actions of the Fresno Unified School District (Fresno), Los Angeles Unified School District, Oakland Unified School District, San Diego City Unified School District, and the California Department of Education (department). Specifically, we found that:

#### **Finding #1: Chartering entities do not ensure that charter schools meet targeted student outcomes.**

In order to hold the charter schools accountable, the Legislature required that each charter petition contain certain elements, including measurable student outcomes proposed by the school to accomplish its educational program. These outcomes give the chartering entity criteria against which it can measure the school's academic performance and hold it accountable. Each

chartering entity we reviewed has interpreted its oversight responsibilities differently, typically developing some practices for overseeing charter schools. However, none of the chartering entities has adequately ensured that their charter schools are achieving the measurable student outcomes set forth in their charter agreements.

A school's charter represents an agreement between it and the chartering entity. The charter agreement is critical for accountability, as it outlines the standards the school is agreeing to be held to; therefore, we expected to find that chartering entities had established monitoring guidelines and activities to ensure that their charter schools were complying with their agreements. Although three of the four chartering entities we visited have chartered schools since 1993, and each has chartered at least eight schools, none had developed and implemented an adequate process to monitor their schools' academic performance. Without periodically monitoring their schools for compliance with the charter terms, the chartering entities cannot determine whether their charter schools are making progress in improving student learning as identified in their charters, nor are the chartering entities in a position to identify necessary corrective action or revocation.

To ensure that the chartering entities hold their charter schools accountable through oversight, the Legislature should consider amending the statute to make the chartering entities' oversight role and responsibilities explicit.

To ensure that charter schools are held accountable for the taxpayer funds they receive and demonstrate accountability for the measurable outcomes set forth in their charters, the chartering entities should consider developing and implementing policies and procedures for academic monitoring. At a minimum, the policies and procedures should outline the following:

- Types and frequency of the academic data charter schools should submit.
- Manner in which the chartering entity will review the academic data.
- Steps the chartering entity will take to initiate problem resolution.



***Chartering Entity Action: None.***

In their initial responses issued with the audit report, the four chartering entities disagreed with our position that they are responsible for the oversight we describe. At the time of the audit, three of the four chartering entities had developed charter school oversight policies and procedures; however, these policies and procedures are not adequate to ensure that the charter schools are achieving the measurable student outcomes set forth in their charter agreements.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

**Finding #2: Chartering entities do not ensure the schools' compliance with various legal requirements that are conditions of apportionment.**

Although exempt from many statutes, charter schools are still subject to at least three legal requirements as conditions for receiving state funds. These requirements include (1) hiring teachers who hold a Commission on Teacher Credentialing permit, except for teachers of non-core, non-college-prep courses; (2) offering, at minimum, the same number of instructional minutes as noncharter schools; and (3) certifying that students have participated in state testing programs in the same manner as other students attending public schools. Requirements 1 and 2 became conditions of receiving state funds beginning January 2002, whereas requirement 3 has been a condition of receiving state funds since January 2000. Since these requirements are conditions of apportionment, we expected to find that the chartering entities had established guidelines and activities to ensure compliance with these legal provisions. Most of the chartering entities we reviewed lack policies and sufficient procedures to validate that all of their charter schools have met these conditions of apportionment. Moreover, although the charter school statute requires an annual audit, these audits do not address all of the conditions set forth in the statute. By not verifying that all of their charter schools comply with these legal requirements, the chartering entities cannot be assured that their charter schools have satisfied the conditions of apportionment.

To ensure that their charter schools are meeting statutory conditions for receiving state funding, the chartering entities should verify these conditions through the schools' independent financial audits or some other means.



***Chartering Entity Action: None.***

In their initial responses to our audit report, the chartering entities disagreed with our audit finding. The entities stated that they had sufficient processes in place to ensure that their charter schools met the various conditions of apportionment.

**Finding #3: Chartering entities lack policies and procedures for sufficient fiscal monitoring and have not adequately monitored their charter schools.**

When chartering entities authorize the creation of a charter school, they accept the responsibility for monitoring its fiscal health. Without fiscal monitoring, charter schools are not held accountable for the taxpayer funds they receive nor will the chartering entity always know when they should require corrective action or revoke a charter. Despite the crucial need for consistent fiscal monitoring, we found that the chartering entities lacked policies and procedures for such monitoring and have not adequately monitored their charter schools' fiscal health, even though some charter schools appear to have fiscal problems. The four chartering entities we reviewed could not demonstrate that they always receive the financial information they request. Moreover, although all four chartering entities asserted that they have procedures for reviewing fiscal data and identifying and resolving problems, none could provide evidence of such. Further, even though all four chartering entities recently developed or adopted new policies and procedures regarding charter schools, only two of those policies address fiscal monitoring and appear to provide for improved monitoring of the chartering entities' charter schools' fiscal health.

Having an audit and correcting noted deficiencies are ways charter schools demonstrate accountability for the taxpayer funds they are entrusted with. Although each charter must specify the manner in which annual independent financial audits shall be conducted, not all audit reports contain all the information relevant to school operations. We expected the chartering entities to have policies and procedures in place for reviewing the audit reports of their charter schools to determine the significance of any audit findings and for ensuring that the

schools resolved reported problems. However, some entities did not adequately review the reports and ensure that reported problems were resolved.

To ensure that charter schools are held accountable for the taxpayer funds that they receive and that they operate in a fiscally sound manner, the chartering entities should consider developing and implementing policies and procedures for fiscal monitoring. At a minimum, the policies and procedures should outline the following:

- Types and frequency of fiscal data charter schools should submit, including audited financial statements, along with consequences if the schools fail to comply.
- Manner in which the chartering entity will review the financial data, including the schools' audited financial statements.
- Financial indicators of a school with fiscal problems.
- Steps the chartering entity will take to initiate problem resolution or to ensure that reported audit findings are adequately resolved.



***Chartering Entity Action: None.***

In their initial responses issued with the audit report, the four chartering entities disagreed with our position that they are responsible for the oversight we describe. At the time of the audit, three of the four chartering entities had developed charter school oversight policies and procedures; however, these policies and procedures are not adequate to ensure that the charter schools are operating in a fiscally sound manner and are accountable for the taxpayer funds they receive.

**Finding #4: Chartering entities cannot justify the oversight fees they charge and risk double-charging the State through mandated-costs claims.**

For fiscal years 1999–2000 and 2000–01, the four chartering entities charged their charter schools more than \$2 million in oversight fees. Nevertheless, none of the four chartering entities could document that the fees they charged corresponded to their actual costs in accordance with statute, because they failed to track their actual oversight costs. As a result, the chartering entities may be charging their charter schools more than permitted by law.



Moreover, these chartering entities also participated in the State's mandated-costs reimbursement process, which reimburses entities for the costs of implementing state legislation. The chartering entities claimed costs in excess of \$1.2 million related to charter schools for the two fiscal years we reviewed. However, because the chartering entities did not track the actual costs associated with overseeing their charter schools, they risk double-charging the State.

Although the statute is clear that the entities' oversight fee is capped at a certain percentage of a school's revenue based on actual costs, it is unclear regarding which revenues are subject to the oversight fee. Consequently, the chartering entities are interpreting the law differently and may be applying the percentage to more revenues than permitted or to fewer revenues than they could be to cover their oversight costs.

To ensure that chartering entities can justify the oversight fee they charge their charter schools and to minimize the risk of double-charging the State for the costs of charter school oversight, they should:

- Establish a process to analyze their actual costs of charter school oversight.
- Compare the actual costs of oversight to the fees charged and, if necessary, return any excess fees charged.
- Use the mandated-costs reimbursement process as appropriate to recover their unreimbursed costs of overseeing charter schools.

To ensure that the chartering entities charge their oversight fees appropriately, the Legislature should consider clarifying the law to define the types of charter school revenues that are subject to the chartering entities' oversight fees.



***Chartering Entity Action: None.***

In their initial responses to our audit report, the four chartering entities disagreed with our finding. The entities said that there is no clear guidance as to what tracking and documentation is required for charter schools expenses.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

**Finding #5: The department could use existing data to identify fiscally or academically struggling charter schools and then question the responsible chartering entities.**

The department plays a role in the accountability of charter schools. The department has the authority to recommend that the State Board of Education take action, including but not limited to charter revocation, if the department finds, for example, evidence of the charter school committing gross financial mismanagement, or substantial and sustained departure from measurably successful academic practices. Although the chartering entity is the primary monitor of a charter school's financial and academic health, the department has the authority to make reasonable inquiries and requests for information. It currently uses this authority to contact a chartering entity if it has received complaints about a charter school.

If the department reviewed the financial and academic information that it currently receives regarding charter schools and raised questions with the chartering entities regarding charter schools' fiscal or academic practices, the department could target its resources toward identifying and addressing potential academic and fiscal deficiencies. In this way, it would provide a safety net for certain types of risks related to charter schools. The concept of the State as a safety net is consistent with the California Constitution, which the courts have found places on the State the ultimate responsibility to maintain the public school system and to ensure that students are provided equal educational opportunities. However, the department does not target its resources toward identifying and addressing charter schools' potential academic and fiscal deficiencies.

To fulfill its role as a safety net, the department should review available financial and academic information and identify charter schools that are struggling. The department should then raise questions with the schools' chartering entities as a way of ensuring that the schools' problems do not go uncorrected.



***Department Action: None.***

In its initial response to our audit report, the department stated that it disagreed with the premise of our audit that the department has the authority and the responsibility to monitor charter schools' fiscal and academic performance. The department stated that it has an established and successful complaint and inquiry process and it chooses to use its limited resources in this way.

**Finding #6: The department does not plan to review audits submitted under Senate Bill 740 to identify fiscally deficient charter schools.**

Senate Bill 740 (Chapter 892, Statutes of 2001), requires each charter school to submit to its chartering entity and the department, by December 15 of each year, an independent financial audit following generally accepted accounting principles. Although not specifically required by the law, we expected the department to plan to review the audits required by Senate Bill 740 in order to raise questions with chartering entities about how they were working with charter schools to resolve the schools' fiscal deficiencies. However, the department does not plan to systematically review charter schools' audits for this purpose. The department will collect but not review the charter schools' audit reports, data which helps reflect the schools' accountability for taxpayer funds.

The department should take the necessary steps to fully implement Senate Bill 740, including reviewing audit exceptions contained in each charter school's audit report and taking the necessary and appropriate steps to resolve them.



***Department Action: None.***

The department stated that Senate Bill 740 does not require it to review charter schools' audit reports for any purpose. The department said that it is implementing all statutorily required activities under this bill, including processing funding determinations, adjusting apportionments, administering the Charter Schools Facilities Grant Program, staffing the Advisory Commission on Charter Schools, and ensuring the Kindergarten through grade 12 audit guide includes audit procedures for elements specified in Senate Bill 740.

**Finding #7: The department cannot assure that apportionments to charter schools are accurate.**

Although the department apportions charter school funds on the basis of average daily attendance (ADA), its apportionment process is faulty because it relies primarily on the certifying signatures of school districts and county offices of education—both of which lack the necessary procedures to ensure that charter schools comply with apportionment requirements. As a result, the department cannot be assured that charter schools have met the apportionment conditions the Legislature has established and receive only the public funds to which they are legally entitled.

So that it does not improperly fund charter schools, the department should work with the appropriate organizations to ensure that charter schools' reported ADA is verified through an independent audit or other appropriate means and that charter schools have met other statutory conditions of apportionment.



***Department Action: None.***

In its initial response to the audit report, the department said it disagreed with the finding related to this recommendation. The department said that current statutes do not provide it with explicit guidance and authority related to verifying ADA, nor is it clear whether the charter schools' audit processes will insure that all statutory conditions of apportionment of state funds are met. The department stated that it believes that the verification of the charter schools' ADA and assurance that other statutory conditions of apportionment have been met are most appropriately determined at the local level.

**Finding #8: Statutory guidance for disposing of a revoked charter school's assets and liabilities is unclear.**

In January 2002 Fresno revoked the charter for Gateway Charter Academy (Gateway). After its revocation action, Fresno sought the department's guidance regarding the disposition of Gateway's assets and liabilities. Fresno's concerns, covering a variety of financial issues, highlight a policy gap regarding a chartering entity's authority following a charter revocation—authority that statutes do not clearly address. For example, Fresno asked for clarification of its role in accounting for and recovering Gateway's assets, particularly since Gateway was no longer a public entity. In addition, Fresno lacked an understanding of how to respond to Gateway's creditors, who were seeking repayment of liabilities. Without established procedures for recovering public assets and addressing potential liabilities, including a clearly defined division of responsibilities assigned to the department and the chartering entity, the State may be unable to reclaim taxpayer-funded assets. Although the recent enactment of Assembly Bill 1994 (Chapter 1058, Statutes of 2002) requires a school's charter to specify closeout procedures, a policy gap remains regarding revoked or closed charter schools.

To ensure that a charter school's assets and liabilities are disposed of properly when it closes or its charter is revoked, the Legislature may wish to consider establishing a method for disposing of the school's assets and liabilities and requiring the department to adopt regulations regarding this process.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

**Finding #9: Recent changes to charter school law may not completely answer existing questions about accountability.**

During its 2001–02 session, the Legislature approved two charter school bills that address some of the issues we raise in our report. Senate Bill 1709, signed into law on August 12, 2002, expands the number of entities to which charter schools—beginning in 2003—must submit by December 15 of each year copies of their annual independent financial audit reports for the preceding fiscal year. However, as we discussed earlier, the department's recent inclusion as a recipient of charter schools' audit reports may not necessarily lead to greater accountability or awareness of charter schools' fiscal health, unless the department reviews the audit reports.

Assembly Bill 1994, signed on September 29, 2002, provides both technical and substantive changes to the charter schools law. For example, this bill requires charter schools, through the county superintendent, to submit an annual statement of all receipts and expenditures (annual statement) from the preceding fiscal year. The annual statements must follow a format prescribed by the department. Furthermore, the bill requires that each county superintendent verify the mathematical accuracy of the charter schools' annual statements before submitting them to the department. These annual statements provide both chartering agencies and the department with additional financial data to assess the fiscal health of charter schools. However, the chartering agencies are not adequately reviewing the financial records and audit reports they already receive. In addition, the department does not use currently available funding data to identify potentially struggling charter schools in order to raise questions with chartering agencies. As a result, without an increased commitment by chartering agencies and the department to monitor charter schools, the level of accountability will not reach its full potential as provided for in the statute.

# ENERGY DEREGULATION

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## ***The Benefits of Competition Were Undermined by Structural Flaws in the Market, Unsuccessful Oversight, and Uncontrollable Competitive Forces***

REPORT NUMBER 2000-134.1, MARCH 2001

Independent System Operator's response as of May 2002

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

*Deregulation of California's electricity market has failed, not as the result of any single cause, but, rather of a complex combination of factors, including:*

- ☑ *Deficiencies in the rules governing the power markets that were created, such as the requirement that investor-owned utilities sell all of the power they generated themselves and purchase all of their electricity through sequential short-term markets.*
  - ☑ *The existence of sequential short-term markets that have encouraged some market participants to engage in strategic bidding, which has contributed to higher wholesale prices.*
  - ☑ *Misjudgments on the part of regulators as to the efficacy of their corrective actions, including decisions made by the Federal Energy Regulatory Commission and the California Public Utilities Commission.*
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At the request of the Joint Legislative Audit Committee, we assessed the Power Exchange's (PX) and the Independent System Operator's (ISO) structure, operations, and overall functionality and the extent to which the activities of the two contributed to the rising cost of wholesale electricity in California. Based on our review, we found the following:

### **Finding #1: The multiple sequential markets operated by the PX and ISO resulted in strategic bidding.**

AB 1890, the legislation requiring the deregulation of California's electrical market, included provisions for creating two nonprofit institutions: the PX<sup>1</sup>, intended to provide an open, competitive commodity market for buying and selling wholesale electricity; and the ISO, intended to centrally manage and control the State's transmission grid. However, the relationship between the PX and ISO was over-designed. Rather than creating one market or entity through which the purchasing and selling of wholesale electricity took place, the two organizations were structured to operate several markets in sequence.

Market participants soon recognized the potential for strategic bidding and adopted various tactics to manipulate wholesale electricity prices. Both buyers and sellers appear to have bid strategically. The market participants' strategic bidding had the result of driving energy sales and purchases out of the PX's primary market and into the ISO's secondary market, which was designed to accommodate only 3 percent to 5 percent of the State's electricity needs. The use of the ISO as a primary market is one factor that contributed significantly to high energy prices and crisis operations.

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<sup>1</sup> On January 31, 2001, the PX suspended trading and filed for bankruptcy shortly thereafter.

To reduce market participants' opportunity for strategic bidding through underscheduling, we recommended that the ISO:

- Cease conducting real-time markets. To fulfill its real-time energy needs, the ISO should undertake to execute forward contracts with generators to provide imbalance energy and reserves for reliability services.
- Consider penalizing scheduling coordinators that submit schedules that do not reflect real-time demand and supply conditions. Penalties would be shared amongst buyers and sellers.

In addition, we recommended that the ISO cease purchasing ancillary services in the spot market and instead:

- Make purchases through secret bids for most of its forecasted ancillary services requirements and significantly reduce its use of spot markets to purchase energy.
- Purchase any short-term ancillary services requirements at individually determined prices, as opposed to paying one price for all such purchases at any point in time.
- Consider the option of contracting for generation capacity. If contracted supply exceeds demand the ISO should be allowed to sell unneeded capacity at cost plus an administrative fee to others through the PX or similar markets.

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

The ISO noted that it believes that none of these options necessarily addresses the underlying source of the market's underscheduling and strategic bidding problems; however, underscheduling and strategic bidding have diminished due to a combination of different market conditions such as lower demand for electricity, the Department of Water Resources making significant forward power purchases, and the Federal Energy Regulatory Commission (FERC) establishing more effective market power mitigation measures.

The ISO also stated that the issue of whether it is an appropriate entity to be entering into long-term contracts is under question and is being addressed as a matter of state policy and as a part of a market redesign process currently underway. The ISO reported that the Department of Water Resources has entered into long-term contracts in a way that

is consistent with several of the recommendations we made including paying on an as-bid basis, maintaining a higher degree of confidentiality about purchase prices, and selling back unneeded energy. The ISO also noted that the new State Power Authority has broad powers that may include forward contracting for energy supplies.

Finally, the ISO stated that its current market redesign, scheduled for implementation on October 1, 2002, contains three key provisions addressing underscheduling and strategic bidding. For example, the ISO is proposing that in order to better plan their future needs, load serving entities bear the responsibility for procuring sufficient resources and reserves for the load they serve.

**Finding #2: The imposition of price caps may have contributed to escalating prices.**

Both the ISO and FERC have used price caps in an effort to control the prices paid in the California market, with mixed success. First, even when demand in the PX was low, the ISO price cap became the minimum bid in some peak demand hours. Additionally, in times of high demand, it is unclear whether any price cap is effective, simply because sellers can bid into the ISO's market through out-of-market transactions, which are not subject to the price cap. The result is higher energy prices, despite the effort to control them.

We recommended that if the ISO is unsuccessful in limiting spot market purchases to very small amounts, it should use price caps only if markets are found to be noncompetitive and supply is being withheld to force prices higher.

***ISO Action: Corrective action taken.***

The ISO reported that the FERC approved its Market Stabilization Plan, which includes new forward energy markets and resource-based bid caps tied to the cost of specific generation resources. However, in the event the mitigation measures FERC approved expire on September 30, 2002, as stated in FERC's June 16, 2001 order, the ISO noted that its market redesign proposal includes two key market power mitigation measures. Specifically, the ISO's proposal calls for mitigating bids that exceed an explicit threshold and/or have a significant impact on projected market clearing prices. In addition, the proposal calls for enhanced mitigation if prices exceed a cumulative 12-month Market Competitiveness Index.



**Finding #3: The ISO lacks authority to effectively schedule power plant outages.**

Another weakness in the structure of the State's power market involves the ISO's lack of authority over generator behavior with respect to scheduled plant outages for maintenance. In light of the evidence that the market is not yet workably competitive, it is unreasonable to grant generators full autonomy concerning the scheduling of plant outages. In fact, despite the ISO arguing that it needed to control scheduled plant maintenance outages in order to be able to effectively balance the system's reliability; the plant owners were allowed to maintain control over such outages. The ISO's lack of authority in this area contributed to the problems in the winter of 2000, as scheduled plant outages coincided with high demand, decreasing supplies, and unscheduled outages due to problems with equipment. If the ISO had some control over the scheduled outages, as do the independent system operators for PJM, New York, and New England, it could have coordinated the scheduled outages more effectively to help alleviate problems with shortages in supply.

We recommended that the ISO coordinate with power generators in scheduling outages for plant maintenance over the next two to three years, or until a competitive market is established. This may not necessarily require that the ISO determine outage schedules, but it will at a minimum require generator participation in scheduling known outages well in advance and in keeping to the schedule established.

***ISO Action: Corrective action taken.***

The ISO reported that it filed a Tariff amendment with the FERC requesting authority to manage power plant maintenance and outages; on October 23, 2001, the FERC approved the ISO's Tariff amendment. In addition, on April 25, 2002, the governor signed Senate Bill 39, Second Extraordinary Session (Chapter 19, Statutes of 2002). This bill, among other things, gave the California Public Utilities Commission authority to examine certain generating plants to ensure that the operators comply with maintenance and operating standards.

**Finding #4: Data published on the PX and ISO Web sites may adversely affect competitive markets.**

Within the California market, specific bidding data are confidential; nevertheless, the ISO and, when it was operating, the PX, periodically published market-clearing price and quantity data on their respective Web sites. The PX also published its market models and gave market participants access to data that would enable them to formulate their own econometric models, such as data on market prices and volume.

Some argue that it was necessary for the ISO and the PX to publish as much data on price and volumes as possible so as to encourage new entry into the market. Although the data have been published only after the fact, when coupled with the published PX pricing model, this meant that predicting market-clearing prices became increasingly easy. Even using stale data, market participants could begin to develop their own models and bidding strategies, and to check their bidding strategy assumptions and adjust them where necessary. With respect to the PX, this point is moot, because the PX has ceased trading in its markets; the ISO, however, is still operating.

We recommended that the ISO:

- Avoid making available to the public any new oversight and market-monitoring models developed.
- Delay making public for at least one year, data for bidding and winning bids. This is especially critical for information concerning long-term contracts the ISO might enter into to meet its ancillary services needs.

***ISO Action: Corrective action taken.***

The ISO stated that pursuant to the FERC's April 26, 2001, Order, it has submitted to the FERC confidential reports examining potential anti-competitive bidding practices. In addition, although we recommended a one-year delay before publishing bidding data, the ISO reports that the FERC has established as appropriate a six-month delay. The ISO also noted that as of May 2001 it ceased making certain real-time market information available on its Web site.



# ENERGY DEREGULATION

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## ***The State's Energy Balance Remains Uncertain but Could Improve With Changes to Its Energy Programs and Generation and Transmission Siting***

REPORT NUMBER 2000-134.2, MAY 2001

California Public Utilities Commission's response as of June 2002  
California Energy Resources Conservation and Development Commission's response as of August 2002

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

*Despite programs to add supply and reduce demand, the State's energy balance remains uncertain:*

- ☑ *Even with projections to the contrary, there is little assurance that the State will meet energy supply needs this summer.*
- ☑ *The State Energy Resources Conservation and Development Commission's (energy commission) AB 970 demand reduction programs are estimated to save 281 megawatts at June 1 2001, however, over one-half of this savings is expected to come from programs that are voluntary in nature.*
- ☑ *Since 1996 the energy commission has approved 12 power plants, but only 4 were approved within 12 months, its statutory goal.*
- ☑ *Despite adding three new processes to hasten power plant siting, only one will add a significant amount of energy to the State's supply in time for summer 2001.*

*continued on next page*

The Joint Legislative Audit Committee requested that we assess the structure, operations, and overall functionality of the California Power Exchange (PX) and the California Independent System Operator (ISO) and if these contributed to the rising cost of wholesale electricity in California. In March 2001 we issued report number 2000-134.1 on the PX and ISO titled, *Energy Deregulation: The Benefits of Competition Were Undermined by Structural Flaws in the Market, Unsuccessful Oversight, and Uncontrollable Competitive Forces*. However, while working on that report, we realized the integral roles played by the California Energy Resources Conservation and Development Commission (energy commission) and the California Public Utilities Commission (CPUC) in California's deregulated energy market. Thus, we issued this second report on energy deregulation, focusing on the energy commission's and the CPUC's responsibilities in the State's energy market.

**Finding #1: The ISO and energy commission's projections of the State's likely balance between electricity supply and demand for summer 2001 are based on assumptions about power outages, customers actions, and other factors that may not come true.**

Despite projections to the contrary, there is little assurance that the State will meet its energy supply needs during the summer of 2001. Responding to the increased public awareness of California's energy crisis, the ISO and energy commission released projections of the balance between electricity supply and demand. These projections, however, are based on assumptions about power plants not operating, customer actions, and

- ☑ *The California Public Utilities Commission (CPUC) does not have an expedited transmission siting process for urgent projects.*
- ☑ *Although the CPUC relies on them for approving transmission projects, the investor-owned utilities' projections of transmission demand growth may not be reliable.*

*Finally, because of the State's role in purchasing electricity for the investor-owned utilities, it remains unclear whether retail competition is consistent with the State's goal of returning the utilities to a creditworthy status.*

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several other factors that may not prove true. Furthermore, the projections do not consider transmission limitations between certain parts of the State or expand the prediction to include more than one possible outcome.

We recommended that the energy commission consult with the ISO and develop an annual projection of summer supply capacity compared to peak demand that acknowledges the full range of constraints within the State's electricity system, including transmission constraints. As part of this projection, the energy commission should provide the Legislature with a range of possible supply and demand outcomes that reflect the underlying assumptions' likelihood of proving true.

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

Over the past year, the energy commission stated that it had worked with the ISO to develop three electricity supply and demand assessment reports published between fall 2001 and spring 2002. The energy commission commented that it has had difficulty working out satisfactory arrangements for receiving key confidential ISO data. However, through the use of a subpoena, it did obtain some specific information to assess generator facility outages occurring during the summer of 2002. Furthermore, the energy commission cited additional analyses it performed for the Legislature assessing potential scenario ranges in energy demand, generation construction, and temperature variation and analyzed additional risks through a probability assessment. It appears that Senate Bill 1389 (Chapter 568, Statutes of 2002) requires the commission to report on issues as we recommended on a biennial basis.

#### **Finding #2: The energy commission's Peak Load Reduction Program may miss its estimate of electricity to be saved by June 2001.**

The energy commission estimated that by June 1, 2001, its Peak Load Reduction Program would provide 281 megawatts (MW) of peak demand reduction. However, the energy commission may be overly optimistic in its estimate. This is because more than half of its estimated 281 MW savings are projected to come during periods of high demand from the voluntary curbing of electricity use in commercial and state government buildings located throughout California. However, actual energy savings

will depend on the operators' responses to potentially frequent requests to reduce electricity use, thus the actual megawatt savings this program will provide are uncertain.

Also, the energy commission's efforts to monitor its water-systems equipment program, which subsidizes the replacement of inefficient water pumps and equipment with more efficient ones, may not be sufficient to ensure that the project schedule will actually be completed by June 1, 2001, in time to provide the planned peak demand reduction for June, which represents 17 percent of its estimated peak energy savings.

We recommended that the energy commission eliminate the override function from the commercial building program guidelines and contract language so that building managers more readily comply with directives to reduce lighting and air conditioning levels as agreed. We also recommended that as a condition of program participation, the energy commission should require commercial building program participants to meet specified compliance levels for a certain period of time, such as 24 months. If the compliance levels are not met, the participants should be penalized.

Finally, we recommended that the energy commission develop a plan to actively evaluate itself and program participants in all components of the Peak Load Reduction Program against set milestones such as:

- Securing a certain number of participants by milestone dates.
- Verifying that equipment is ordered and delivered by scheduled due dates.
- Projects are installed, completed, and tested according to scheduled dates.

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

In its responses to these recommendations, the energy commission reported that the utilities will and the ISO may assess penalties if building operators do not provide contracted load relief and that this was as much assurance of performance as they could achieve independently. The energy commission told us that it is actively evaluating the peakload reduction program. In addition, its managers are monitoring each contract relative to its milestones. The energy commission reports that it is conducting site visits

where possible and has contracted with an outside evaluator to provide monitoring and program impact verification. It also stated that the evaluator's first report was submitted in January 2002 and others are to be provided on a quarterly basis, but did not state the results of these reports.

**Finding #3: The CPUC's energy efficiency programs may not achieve planned peak energy savings and cost much more than larger commercial and industrial peak energy savings programs.**

Through its self-generation program, the CPUC subsidizes electricity customers' purchases and installation of solar panels, fuel cells, and nondiesel internal combustion engines, to allow these customers to generate their own electricity rather than drawing energy from the transmission grid. However, the CPUC allows customers their choice of the type of self-generating technology they wish to install rather than focusing on maximizing the reduction in peak demand. As a result, customers' technology choices will greatly affect the megawatt savings the CPUC will achieve.

Additionally, the CPUC's new demand control efforts, which include a plan to adjust thermostats during times of peak electricity use, may fall short of its estimated megawatt savings goal of 8 MW in 2002. Under this plan, participants will have the ability to override the signal to adjust their thermostats, partially or wholly negating any energy savings.

In addition, the Web site the CPUC directed PG&E to develop calls for PG&E to duplicate information already residing on the respective Web sites of PG&E, private entities, and public entities. Thus, we believe the \$3 million annual cost for the Web site is a poor use of ratepayer funds.

Finally, the self-generation and demand control programs will cost the ratepayers of the three investor-owned utilities \$551.5 million, nearly six times more costly on a per megawatt saved basis than the energy commission's Peak Load Reduction Program. Even though AB 970 requires the CPUC to address small energy customers, it does not preclude the CPUC from including larger industrial and commercial customers in its demand reduction programs. Therefore, we questioned whether the CPUC should continue to commit utility ratepayers' funds

only to residential and small commercial programs when funds collected from and applied to larger ratepayers could achieve greater peak energy savings.

We recommended that the CPUC:

- Amend the new residential and small commercial pilot programs to remove the override option from the program and to require participants to reduce peak demand as and when directed.
- Remove the Web site from its portfolio of demand control programs.
- Increase its vigilance in its oversight of the investor-owned utilities' administration of energy efficiency programs.
- Give priority to conservation measures for those types of customers who will produce the most energy savings.

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

In its one-year audit response, the CPUC stated that to address concerns about utility administration, it established a new framework for proposals for new energy efficiency programs beginning in calendar year 2002. The CPUC described the framework as providing an opportunity for entities other than the utilities to develop and implement innovative new energy efficiency programs. Moreover, the CPUC believes that its new *Energy Efficiency Policy Manual*, adopted in November 2001, will help prioritize funding for programs with the highest energy savings through a uniform method for measuring the cost-effectiveness of various alternative programs and quantifying long-term energy savings. However, the CPUC provided no response covering their efforts to implement our other recommendations. These recommendations remain valid because:

- Under the demand control pilot program participants can override the signal to adjust their thermostats, thereby diminishing the peak demand savings the CPUC hopes to achieve.
- The Web site CPUC directed PG&E to develop was duplicative of existing sites. Thus, the \$3 million annual cost to maintain the Web site is a poor use of ratepayer funds.



**Finding #4: The potential for wide swings in electricity supply may require that the State augment its role in energy planning.**

After the State deregulated the electricity industry, the energy commission no longer played a role in restraining the State's level of electricity supply. Instead, the State relied on the competitive market to encourage the construction of sufficient power plants to ensure an adequate supply of power. However, relying on the marketplace to determine when to increase supply may not be in the State's best interests. Because power plants take a significant amount of time to site and construct, the industry may not be able to respond quickly enough to market signals to ensure that the State is not exposed to a boom-bust cycle. To avoid these large fluctuations in electricity supply, it may be valuable for the State to augment its planning role, ensuring that California never reaches extreme levels of oversupply or undersupply.

We recommended that the Legislature and energy commission consider augmenting the energy commission's role in electricity planning to help ensure the State avoids large swings in the supply of electricity relative to demand. For example, expanding the energy commission's existing planning role to include integrating supply and demand projections and to use them as a basis for making decisions on whether to site new power plants.

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

The energy commission reported that it published its assessment of the projected supply and demand for electricity, natural gas, and related issues over the 10-year period 2002 through 2012, in May 2002. The energy commission reported that it has briefed the California Power Authority on its report and is participating in a proceeding with them to develop a target reserve margin. In addition, the energy commission noted that Senate Bill 1389 (Chapter 568, Statutes of 2002) will consolidate and enhance its data collection, forecasting, and reporting responsibilities by requiring the energy commission in consultation with certain state and federal agencies to prepare a biennial Integrated Energy Policy Report. The energy commission believes that the assessments and forecasts included in these reports will help it develop energy policies that conserve resources, protect the environment, ensure energy reliability, enhance the State's economy, and protect public health and safety.

**Finding #5: The energy commission has made changes to improve its siting process but is not evaluating the effectiveness of those changes.**

In response to a legislative mandate, in March 2000, the energy commission issued a report on improvements that it could make to its siting process. As of April 1, 2001, the energy commission stated that it had implemented over half of the changes it identified. However, the energy commission has not developed methods to judge the effectiveness of its changes. For example, to prevent delays, the energy commission changed its regulations to specify that outside parties could only request information on applications within 180 days of the date the application is complete. However, the energy commission has not attempted to measure whether this new procedure has actually prevented the delays it previously identified. Thus, the energy commission cannot guarantee that this change and others it has made have actually improved the generation siting process as intended.

We recommended that the energy commission establish an evaluation plan to assess the impact of recent changes to its process for siting power plants.

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

The energy commission reported that it had developed a power plant permitting database to record key events and other data relating to the power plants being reviewed or permitted. The energy commission stated it has the ability to query the database to determine if there are any measurable improvements attributable to changes it has made to the permitting process. In addition, the energy commission stated it intended to hold post-certification debriefings with stakeholders to gather qualitative information on the outcomes of the permitting process.

**Finding #6: Having utilities responsible for transmission planning may hinder the development of new transmission lines.**

The investor-owned utilities are primarily responsible for transmission planning, determining through their own separate analyses of demand growth what new transmission lines are needed and where. The ISO and CPUC coordinate, plan, and oversee the expansion of the State's transmission grid. Because the three investor-owned utilities create three individual transmission

expansion plans, based on potentially varying assumptions of the future demand growth in their respective service areas, the ISO's ability to create a comprehensive statewide expansion plan may be hindered. Also, the investor-owned utilities may have incentives that conflict with their responsibility to expand the grid where necessary. Therefore, the investor-owned utilities' demand analyses may not be the best basis for determining when and where transmission lines are needed. In relying on these analyses to determine transmission line expansion, rather than on analyses prepared independently, the ISO and CPUC lack assurance that the utilities' proposed transmission projects are optimizing the transmission grid.

We recommended that the energy commission make regional demand growth projections for the ISO and CPUC to use in their transmission planning and siting processes so that the State has an independent projection of demand growth on which to base transmission expansions.

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

The energy commission reported that its electricity demand analysis and projections are available to and can be used by the CPUC and the ISO. In addition, the energy commission stated that it works with many out-of-state electricity planning entities and utilities to establish a common understanding of the Western Systems Coordinating Council's regional developments.

**Finding #7: The CPUC's transmission siting process is not responsive to the current energy crisis.**

Although it is responsible for siting the electrical transmission lines that the investor-owned utilities propose, the CPUC does not have an expedited transmission siting process that could better assist California's recovery from the energy crisis. Moreover, in almost half of the CPUC's siting cases using the environmental review process outlined in the California Environmental Quality Act (CEQA), the CPUC significantly exceeded the 180- and 365-day goals CEQA sets for completing environmental reviews. A lack of adequate transmission capacity in some areas of the State can be devastating—transmission constraints have already caused rolling blackouts and have the potential to do so again in the near future. Also, long delays in siting added transmission could slow the State's recovery from the current energy crisis.

We recommended that the Legislature:

- Create an expedited electricity transmission siting process for projects that are needed for short-term transmission system reliability.
- Institute a coordinated electricity transmission siting process as it relates to other agencies similar to the coordinated power plant siting process used at the energy commission.

***Legislative Action: Unknown.***

We are not aware of any legislative action concerning this recommendation.

**Finding #8: The future of consumer choice is unclear.**

In California's deregulated electricity industry, energy customers can choose to stay with the investor-owned utilities or purchase their electricity from another provider. The CPUC and the Legislature had high expectations that consumer choice would increase competition and lead to lower electricity prices. However, Californians never fully realized these benefits of consumer choice because certain features of deregulation and its implementation kept consumer choice from flourishing. Now, the future of consumer choice is in doubt because the State has become the main purchaser of wholesale electricity for the investor-owned utilities, negotiating long-term contracts with energy generators. The goals of consumer choice may conflict with the State's goal of returning the investor-owned utilities to creditworthy status—because expanding competition at this point might result in the State paying for unneeded power.

We recommended that in assessing the future role of consumer choice, the CPUC should consider the effects of competition at the retail level to evaluate whether it is viable in the current market environment, where the State is the primary purchaser of electricity for the investor-owned utilities.

***CPUC Action: Corrective action taken.***

On September 20, 2001, the CPUC suspended direct access for all new customers. In February 2001 the Department of Water Resources (DWR) began purchasing electricity on behalf of California's utility customers. By suspending direct access, the CPUC acted to stabilize the electric utility customer base and ensure that the DWR did not purchase more power than was necessary.



# CALIFORNIA ENERGY COMMISSION

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## ***Although External Factors Have Caused Delays in Its Approval of Sites, Its Application Process Is Reasonable***

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

*Our review of the California Energy Commission's (energy commission) siting and approval process revealed that:*

- ☒ *Although the energy commission has not always approved applications within the standard 12-month period, setbacks were due to a combination of factors.*
  - ☒ *Of the four states with comparable processes, only Oregon, at 30 months, took longer than California to approve applications. Minnesota, Florida, and Connecticut took between 7 and 15 months to approve applications, while the energy commission averaged nearly 17 months.*
  - ☒ *The energy commission is able to approve projects quicker than other permitting processes in California because it combines activities that are performed consecutively under other processes.*
  - ☒ *Ten applications have been approved under the new 21-day expedited process, adding over 850 megawatts of electricity to the State's supply.*
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**REPORT NUMBER 2001-118, AUGUST 2001**

**California Energy Commission's response as of December 2002**

The Joint Legislative Audit Committee (audit committee) requested that we examine the application process used by the California Energy Commission (energy commission) for approving new energy generation facilities. Specifically, the audit committee requested, among other things, that we review the appropriateness of procedures and time limits of the application process, the viability of the energy commission's expedited process, and the appropriateness of certifying the application process as equivalent to CEQA. We found that while the energy commission frequently missed the required 12-month deadline for approving applications, the actions of other parties often contributed to the delays.

Additionally, our review of Minnesota, Texas, Florida, Connecticut, and Oregon suggested that, with the exception of Texas, the tasks performed by each state when approving applications were generally similar. Minnesota, Florida, and Connecticut averaged approval times of between 7 and 15 months, Oregon averaged 30 months, and the California energy commission averaged nearly 17 months—2.5 months to assess the adequacy of the application and more than 14 months to approve it. Furthermore, the energy commission's process is more efficient than other equivalent processes available in the State. Specifically, whereas state regulations generally require the energy commission to approve applications within 12 months after deeming them complete, the California Environmental Quality Act and the Permit Streamlining Act allow up to 24 months for the approval of other types of projects that have a similar environmental impact.

Finally, the energy commission expects that 10 projects recently approved under its new 21-day application process will add over 850 megawatts of electricity to the State's supply by the end of September 2001.

**Finding #1: The energy commission's approval process has generally taken longer than 12 months.**

The energy commission has not always approved applications within the standard 12-month period. For 10 (43 percent) of the 23 applications approved since 1990, the energy commission missed the 12-month standard for approval by more than 30 days. Although the energy commission is ultimately responsible for the approval process, multiple factors contributed to the delays for most of these 10 projects and some of the delays were outside the energy commission's control. For all of the 10 applications that were approved late, applicants did not submit some of the required information in a timely manner. For 7 of these applications, other local, federal, and state agencies failed to process approvals promptly. In addition, outside parties raised objections to some of the proposed sites, thus delaying the approval of 3 applications.

Finally, the energy commission holds public workshops in which it attempts to resolve issues with applications. However, some of the delays caused by public intervention may be the result of the energy commission's failure to enforce its own standards for public workshops and requests for information. The energy commission's regulations generally allow 180 days from the date an application is deemed complete for groups to become intervenors and request additional information. Additionally, the energy commission's internal guidelines establish the same time frame for holding public workshops. However, in some cases since 1990, intervenors submitted data requests, and staff held public workshops, well past the 180-day standard. In fact, for 7 of the 10 applications that were approved late, workshops were held 220 days or more after the energy commission determined that the application was adequate.

The energy commission should exercise its authority to terminate applications when the applicant does not appropriately respond to requests for data. The energy commission should also more strictly enforce its standards that limit the time allowed for intervenors and other agencies to raise new issues and submit data requests to 180 days from the date the energy commission accepts the applications. Finally, the Legislature should consider establishing a firm 180-day deadline for intervenors to raise issues and submit data requests.

***Energy Commission Action: None.***

According to the energy commission, as a result of deregulation, California is presently dependent on certain power plant developers to bring on needed new generation to ensure system reliability. The energy commission also indicated that because many energy companies have lost significant stock value, energy companies that filed applications with the energy commission decided to delay project development to improve their balance sheets. The energy commission believes that, in this tenuous business environment, any action by the energy commission that can be seen as negative can have significant adverse consequences. Consequently, the energy commission plans to continue to suspend rather than terminate projects when applicants are not timely in submitting needed data.

The energy commission also noted that a strict 180-day limit for intervenors to raise issues and ask for information would address, to some degree, related delays. However, the energy commission believes the uniqueness of each project with its own issues and potential changes to the project design suggests that the flexibility provided in the current regulations should be maintained.

***Legislative Action: Unknown.***

We are not aware of any legislative action concerning this recommendation.

**Finding #2: The energy commission's development of expedited siting procedures may allow for faster approval of applications.**

The energy commission developed new 4-month and 21-day expedited processes to bring more power on-line for the summer of 2001. Additionally, to address concerns that construction of new power plants has seriously lagged in the past decade, the energy commission also established a 6-month certification process for thermal power plants that have no adverse environmental impact. It remains too early to determine whether the 6- and 4-month processes will be effective because only one project has been approved under either of these processes. However, the energy commission has approved 11 projects under the 21-day process.



We recommended the energy commission evaluate the effectiveness of the expedited 6- and 4-month processes and determine their long-term viability after an appropriate amount of time has elapsed.

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

The energy commission believes that the 4-month application process was appropriate given the severity of the energy crisis California faced in 2000 and 2001. However, because of the low percentage of projects it approved as 4-month applications (2 of 14 projects), the energy commission believes it would not be beneficial to reestablish this permitting process after January 1, 2003, its current sunset date.

Additionally, the energy commission expects to approve only 1 of the 12 projects submitted under the 6-month certification process. According to the energy commission, the application requirements for the 6-month certification process are more comprehensive than for the 12-month process and have resulted in projects being delayed while the developer attempts to complete the requirements. In the past two years, the energy commission's experience has been that when unexpected permitting issues arose requiring additional time to resolve, projects were converted to 12-month applications to provide additional time to review. The energy commission believes that in order for the 6-month application process to be successful developers need to carefully select sites and design their proposal to avoid or mitigate any potential environmental and other issues before filing their application. However, the energy commission stated that it continues to support the use of the 6-month application process and it plans to continue to work with developers to implement this review process for appropriate projects.

# BLACKOUT PREPAREDNESS

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## ***The Office of Emergency Services and the California National Guard Each Have Weaknesses in Their Blackout Preparations***

REPORT NUMBER 2001-111.1, SEPTEMBER 2001

Office of Emergency Services' response as of October 2002

California National Guard's response as of September 2002

The Joint Legislative Audit Committee asked us to determine whether the California National Guard (CNG) has a plan to deal with blackouts resulting from the State's energy shortage. Our review also includes an evaluation of the Office of Emergency Services' (OES) plan since it is primarily responsible for assuring the State's readiness to respond to and recover from man-made emergencies such as electrical blackouts. Specifically, we found:

### **Finding #1: The OES has an alternative power source during a blackout but other concerns about its preparedness exist.**

In the event of a blackout, the OES has a generator at its headquarters as an alternative power source. The OES headquarters houses its State Operations Center, which is one of the key locations it uses to receive and process local government's requests for assistance. According to the OES, it runs and inspects the generator on a regular basis, which is a reasonable precautionary step to ensure that this critical facility will have power. However, the OES may have other weaknesses that can affect its blackout preparedness.

In March 2001 the OES distributed to its staff an Energy Shortage Response Matrix (response matrix), which provides background and insight into potential public safety impacts, state actions to date, and its policy relating to energy responses. For example, the OES found that an evaluation of its plans for transferring responsibilities for critical functions to unaffected units and relocating staff to an alternative work site was necessary to refine its Business Continuity Plan (continuity plan). It also recognized the need to evaluate its continuity plan and emergency procedures to ensure back-up systems are operating

and whether it could handle a natural disaster during an energy crisis. The OES asserts that it has taken steps to address some of the activities found in the matrix, but we are uncertain if or how it has resolved a few key concerns it raised in its response matrix.

To strengthen its blackout preparedness, the OES should, at a minimum, review and document its efforts to ensure that its relocation and transfer plan, business continuity plan, and emergency procedures address sufficiently the State's energy situation.



***OES Action: None.***

The OES' one-year response to our recommendations was simply a reiteration of all of its previous response letters. The OES states that weaknesses in blackout-specific preparedness activities were already addressed by pre-existing, all-hazard emergency management practices. We disagree. The OES prepared a response matrix in March 2001 and for certain potential public safety impacts, the OES identified additional steps it should take to minimize disruptions to its operations. For example, it recognized the need to evaluate whether it could handle a natural disaster during an energy crisis. Because the OES identified these concerns itself, it seems clear that they were not already addressed by pre-existing practices as the OES is now claiming.

Further, we disagree with OES' belief that its continuity plan and Relocation and Transfer Plan can address a potential blackout situation. In June 2001 the OES identified concerns with its continuity plan and Relocation and Transfer Plan. Moreover, since the OES did not provide us with any evidence such as changes it made or changes that may be pending during the audit or as part of its most recent response, we question whether it has taken the necessary steps to resolve its concerns about its own preparedness.

**Finding #2: The OES has taken steps to inform the emergency response community and others about blackouts but some efforts could be stronger.**

In addition to preparing itself for blackouts, the OES has worked with the emergency response community to share information about the energy crisis and assist them in planning for blackouts. The OES has also implemented a notification process that provides for a series of alerts prior to a potential blackout. However, the OES lacks a way to evaluate its effectiveness

and therefore, may overlook necessary changes or improvements. Finally, the OES developed a guide for local governments in planning for power outages. Although this document addresses many critical planning issues, the OES may not be able to assist local governments because it has not designated staff to respond to inquiries nor has it trained its staff on how to use the planning document.

We recommended that the OES establish a method to periodically evaluate its notification process, which includes documenting the results of its evaluations and following up with participants to ensure that all necessary changes are made. In addition, the OES should assign specific staff to be responsible for responding to local governments' inquiries about its power outage planning guide. It should also train these staff on how to use the guide and advise local governments on their planning efforts.



***OES Action: None.***

The OES' one-year response to our recommendations was simply a reiteration of all of its previous response letters. The OES states that there is no need for it to specifically evaluate its notification process because the OES uses these same tools for all other types of disasters and emergencies daily. We disagree. In a meeting held on August 14, 2001, the deputy director of Emergency Operations, Planning and Training Division agreed that a formal, periodic assessment of how the notification process is working would be beneficial to identify process improvements. The deputy director also told us that the OES' blackout notification process improved upon its prior notification procedures. For example, it allowed for expanded use of its Emergency Digital Information Service and the incorporation of its Response Information Management System. Therefore, we would expect the OES to ensure that these new enhancements are effective.

The OES stated further that even though there are some issues unique to blackouts, there is no need to designate or train staff to respond to local government's inquiries because these capabilities exist within its structure already. We disagree. Because the OES did not designate and train staff to accept these inquiries, there is a potential that when the local governments contact the OES for assistance, they may get passed on to multiple staff and not receive the help they need at all. Moreover, because as the OES states there are issues that are unique to blackouts,

despite their technical expertise in overall emergency management operations, staff may not be able to assist the local government in using OES' Electric Power Disruption Toolkit for Local Government.

**Finding #3: Although its communication systems are redundant, the CNG's lack of maintenance weakens these systems.**

The CNG's outage plan specifies that the armories are to rely on commercial telephone systems as the primary means of communication. If commercial services are unavailable, the plan directs staff to use two alternative communication methods: high frequency radios (HF radios) and cellular phones. Although the CNG's outage plan appears reasonable in that it provides for redundant methods of communication, because the CNG does not ensure that its HF radios and cell phones are intact and operational, it cannot be certain that these alternatives will be available when necessary.

To strengthen its readiness for blackouts, the CNG should develop a plan that sets forth inspection dates for each location with a HF radio, the person responsible for the inspection, and a date certain for the completion of all repairs; and continue with these maintenance checks on an ongoing basis. In addition, the CNG should establish a process to periodically check that each cell phone is operating and the batteries are fully charged.

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

In its six-month response, the CNG provided us with a maintenance schedule for its 19 HF radios including a party responsible for inspections and an inspection date and stated it planned to inspect all the radios by March 2002. The CNG also provided information demonstrating that it had made six of its planned visits. In its one-year response, the Guard stated it regularly conducts radio operations checks from its headquarters, but is attempting to identify funding to continue the periodic maintenance inspections and repairs. The Guard did not indicate how many radios required repair.

The CNG also reported that it recalled the cell phones it issued to the armories but these phones can and will be issued if necessary.

**Finding #4: The CNG does not monitor its tactical generators' operability.**

The CNG's outage plan specifies that tactical generators may be used in CNG facilities when power is essential for safety, security, and mission requirements. The CNG normally uses tactical generators when staff are in the field and need a power supply for their equipment. Although these generators cannot be connected to the buildings' electrical system to supplant traditional power sources, they can be used to operate portable light fixtures and radios thereby contributing to the normal operation of a CNG facility during a blackout. However, the CNG does not ensure its facilities periodically test its tactical generators. Therefore, the CNG has limited assurance that it can use these generators in the event of a blackout.

We recommended that the CNG develop policies and procedures for testing and maintaining its tactical generators and include these policies and procedures in its outage plan. In addition, the CNG should continue to monitor the operational status of these generators.

***CNG Action: Corrective action taken.***

The CNG reports that it has amended its Power Outage Plan, which now includes a requirement for field commanders to test their units' tactical generators monthly. The headquarters staff will also review monthly maintenance reports the units submit in order to monitor the generators' operational status.

**Finding #5: The CNG does not include in its plan or adequately monitor its headquarters' back-up generators.**

The Department of General Services expects state agency and department emergency plans to address how they will ensure that any back-up generator sources are tested and readily available. Although the CNG's plan addresses tactical generators, it does not address the back-up generator in its headquarters building. According to the Director of Plans, Operations and Security, once a week an automatic timer trips and the back-up generator will start up and run for several minutes to ensure the generator is working properly. Because the back-up generator is critical to the CNG's Joint Operations Center during a blackout, we would expect it to include this generator in its plans and to have policies and procedures in place for tracking the weekly generator test and as part of that test, inspecting the generator

for sufficient fuel, leaks, or other malfunctions. However, according to the Military Support Civilian Authorities Communications Officer responsible for the headquarters' generator, no such policies or procedures exist; he simply listens for the generator to start up each week.

We recommended that the CNG update its outage plan to address its headquarters' back-up generator that it needs to operate its Joint Operations Center, periodically inspect it for leaks, check its fuel levels and other critical elements, and execute a maintenance contract to ensure that more extensive inspections occur on an ongoing basis.

***CNG Action: Corrective action taken.***

The CNG amended its Power Outage Plan to include weekly tests of its headquarter's back-up generator. In addition, the CNG developed a preventative maintenance inspection checklist to follow when testing the generator. Finally, the CNG noted that a contractor inspects the generator quarterly.

# CALIFORNIA ENERGY MARKETS

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## ***Pressures Have Eased, but Cost Risks Remain***

REPORT NUMBER 2001-009, DECEMBER 2001

Department of Water Resources' response is not applicable at this time because we are performing another audit to follow up on these issues.

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

*The Department of Water Resources (department) faced an immense challenge in purchasing the net-short energy of the three investor-owned utilities. The department entered into 57 long-term contracts for power with an estimated cost of \$42.6 billion over the next 10 years. Although the energy crisis has now eased, significant cost and reliability risks remain. Specifically, we determined that:*

- ☒ *The speed in which the department entered into contracts in response to the crisis precluded the planning necessary for a power-purchasing program of this size. As a result, it assembled a portfolio of power contracts that presents significant risks that will need careful management to avoid increased costs to consumers.*
- ☒ *The portfolio does not contain sufficient power for peak-demand periods, thus potentially exposing consumers to high market prices if energy supply becomes limited during those periods.*

*continued on next page*

Assembly Bill 1 of the 2001–02 First Extraordinary Session (AB IX) directed the Bureau of State Audits to conduct a financial and performance audit of the Department of Water Resources' (department) implementation of the Purchase and Sale of Electric Power Program (power-purchasing program). The California energy crisis, which peaked between late 2000 and mid-2001, was unprecedented. Energy prices rose to all-time highs, and blackouts occurred in several instances. The State's three largest investor-owned utilities soon experienced credit problems and had difficulty convincing energy power generators to sell electricity to them.

In response to the crisis, the Legislature authorized the department to purchase the net-short energy for the three largest investor-owned utilities. The net-short energy is the difference between the power that the investor-owned utilities provide and consumer demand, an amount that varies considerably. Through September 2001, the department spent \$10.7 billion purchasing the net short. While the department managed to provide the needed electricity, we found it was not prepared for the immense task and is still building its capacity for a power-purchasing program of this size. To reduce the State's dependency on volatile spot market prices, the department entered 57 long-term power contracts at a total value of approximately \$42.6 billion over the next 10 years. However, the portfolio of power purchase contracts the department assembled contains cost and legal risks that must continue to be carefully managed, and most contracts do not provide the reliable power intended by AB 1X. Specifically, we found:



- ☑ *The majority of the contracts are not written to ensure a reliable source of power, but instead they convey lucrative financial terms upon the suppliers to ensure that energy is delivered. In addition, the terms of the contracts contain provisions that can increase the cost of power; thus they need careful management to avoid additional costs to the consumers.*
  - ☑ *The department lacks the infrastructure needed to properly manage the purchases of the net short, but is taking steps to build up its capabilities.*
  - ☑ *Many decisions need to be made about the State's future role in the power market. The department's authority to contract and purchase the net short ends after 2002, yet it or another entity will need to manage the considerable market and legal risks of the power contracts and, if the utilities are not creditworthy, purchase the net short.*
  - ☑ *Operational improvements are needed to strengthen the department's administration of the power-purchasing program.*
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### **Finding #1: The department's contract portfolio contains cost risks that must continue to be carefully managed.**

The portfolio that the department has assembled as a response to the crisis emphasizes year-round energy but does not similarly emphasize delivery during peak demand hours. The risk in the portfolio that the department must carefully manage is that the portfolio leaves it exposed to substantial market risk in high peak demand periods if supply shortages occur and to substantial market risk with surplus contract amounts in other hours of the year. Compounding this problem is that many of the contracts are nondispatchable, meaning that the department must pay for the power whether or not it is needed. Further, based on present forecasts from the fourth quarter of 2003 through the first quarter of 2005, the department has procured more power than consumers in Southern California need. Because facilities powered by natural gas produce most of the energy for which the department contracted, the department could also have employed more tolling agreements, which would have allowed the contract price to decrease if gas prices decrease, as is predicted. However, according to the department, before receiving an opinion from the attorney general on February 28, 2001, affirming its authority, the department was not certain that AB 1X authorized it to purchase the natural gas supplies required under tolling agreements. The department is considering various mitigation strategies for these risks and the extent to which the strategies will be successful is unknown at this time.

The department's rush to obtain contracts quickly—it entered about 40 agreements with a value of \$35.9 billion in just 30 days—may have played a role in the composition of the portfolio because the department's rush precluded the planning and analysis that are necessary for developing a portfolio of this magnitude. Given the urgency to gain control of power prices and the pace that it chose in reacting to the crisis, the department had little opportunity to conduct the planning that was needed. The choice to move quickly was one of the options that the department could have taken. However, going slower may have resulted in a portfolio with fewer, or less extensive, cost risks to manage.

To effectively plan and manage the economic aspects of its portfolio, we recommended that the department gain a firm understanding of the risks contained in the portfolio. Specifically, the department should conduct within 90 days an in-depth economic assessment of its contracts and the overall supply portfolio that serves customers of the investor-owned utilities.

This assessment should occur in conjunction with a legal assessment of the contract portfolio to assure that the department develops an effective overall strategy for contract management. Further, this assessment should focus on how the contracts fit into the overall supply of power and on the contract costs relative to current expectations of market conditions. The department should also establish a planning process that more directly integrates the entire portfolio of supplies serving the customers of the investor-owned utilities with the contract portfolio. Finally, the department should develop a contract renegotiation strategy that focuses on improving the reliability and the overall performance of the portfolio.

***Department Action: Pending.***

The department's implementation of our recommendations is being further evaluated with audit 2002-009, which we are scheduled to release in March 2003.

**Finding #2: The department's power purchase contract portfolio may not always provide for the reliable power intended by AB 1X.**

Most of the contracts that the department has entered with power generators do not include the terms and conditions that one would expect to see in agreements that ensure the reliable supply of energy. A key goal of AB 1X is for the department to obtain a portfolio of power contracts to supply a reliable source of power at the lowest possible cost so that the State could address the unprecedented financial and supply emergency in its electricity markets. When measuring the adequacy of the terms and conditions of the contracts, we analyzed them to determine whether the contracts assure reliable delivery of power in times of high prices and tight supply.

Our detailed review of 19 transactions, constituting 61 percent of the total gigawatts purchased, and a screening of others concluded that most of the power supplies fall under contracts with terms and conditions that may not always assure that reliable sources of power will be available to the department. For example, under the terms of most of the contracts, the department cannot terminate the contract or assess penalties even if generators repeatedly or intentionally fail to deliver power at times when the State urgently needs power. Instead, the department can only recover the difference between the contract price and the cost of the replacement power. The right to terminate the agreements when generators repeatedly fail to

deliver would have provided the department the leverage to compel generators to deliver power in times of severe need or to replace generators with other, more reliable generators.

The department's contracts also often lack terms and conditions that would better ensure other reliability goals of the contracting effort. For example, they lack provisions that would better ensure that generators are making appropriate progress on building the facilities that will supply the power for which the department has contracted and allowing the department to inspect facilities that the generators say are unable to produce power because of mechanical difficulties. Moreover, the contracts may not always ensure that when the State pays a premium for construction of new generating facilities, the new construction occurs and the generators actually make available and deliver the power produced by the new facilities.

Although the department was in a weak bargaining position because of the financial crisis in the electricity markets, its rush to ease the electricity crisis by locking in power supply through long-term contracts weakened its position even further. In its request for bids, the department did not request contract terms and conditions that are standard in the power industry for entities that must ensure reliable delivery of power. We found that in later contracts sellers agreed to terms and conditions that better assure reliable power delivery. Because the department apparently did not ask for certain reliability terms recognized by the power industry until after it had made the bulk of the deals, we cannot determine whether the department would have been able to obtain more favorable reliability terms in the earlier long-term contracts. We did note that while the terms and conditions improved in the long-term contracts negotiated after March 2001, the department negotiated the vast majority of the power, costing \$35.9 billion, before March 2, 2001, during the period in which we found that the terms and conditions regarding reliability of power delivery were least favorable to the State.

Finally, another concern is that the contract costs are not fixed and could rise substantially if the department does not manage its legal risk in anticipation of exposure to potential liabilities and to defaults by energy sellers. For example, the department needs to guard against potential events of default that could expose the State to huge early termination payments. Also, the department needs to protect itself from generator costs that the

contracts have shifted to the department. Such costs could include governmental charges, environmental compliance fees, scheduling imbalance penalties, and gas imbalance charges.

We recommended that the department undertake actions to anticipate and manage its legal risk in its contracts. Specifically, to ensure that the department can develop an effective strategy for managing these contracts, it should perform within 90 days in-depth assessments of its legal risk and legal services requirements. Further, to make certain that its legal assessment and representation is on par with those of the other parties participating in the contracts, the department should establish an ongoing legal services function that specializes in power contract management, negotiation, and litigation. When necessary to avoid conflicts, this legal function should be distinct from counsel retained to sell bonds or provide legal advice to the State Water Project. Finally, it should investigate all audit and other rights available to the department under the contracts to assure that it can develop a proper program to enforce the power suppliers' performance.

***Department Action: Pending.***

The department's implementation of our recommendations is being further evaluated with audit 2002-009, which we are scheduled to release in March 2003.

**Finding #3: The department lacked the infrastructure to carry out the power-purchasing program.**

Once the department became responsible for the net short, it began purchasing up to 200,000 megawatts of electricity each day. Through September 2001 the department spent approximately \$10.7 billion on transactions for short-term power agreements. However, various factors hampered the department's efforts in its new role, including a dysfunctional market and a lack of infrastructure and experienced, skilled staff. In addition, the department is still developing systems for working with the investor-owned utilities to forecast demand, schedule the least-cost available power, and manage the delivery risks. Consequently, at the same time that the department struggled with purchasing needed power, it also struggled to establish the organization it would need to meet the challenge.

The department also still needs to resolve settlement process problems associated with the energy and ancillary services functions that the department has been conducting and

continues to conduct on behalf of the California Independent System Operator (ISO). This resolution is important because under a recent Federal Energy Regulatory Commission (FERC) order, the failure of the department and the ISO to reach agreement on how to facilitate the payment of long-outstanding power obligations may disrupt the future supply of available power in the ISO's short-term markets.

We recommended that the department fully staff the power-purchasing program and consider staffing approaches, including hiring additional consultants and contractors if needed, to assure that personnel shortages do not continue to hinder its operations. In addition, we recommended that the department enhance its skills for market analysis and contract management to properly address the implications of uncertainty on contract portfolio management and power dispatch decisions. The department also needs to develop a transition plan for the orderly transfer of the short-term purchasing and net-short management functions to other entities. Further, it needs to collaborate with the investor-owned utilities to share information about generation sources to ensure the least-cost dispatch of power. As part of this effort, the department should coordinate with the investor-owned utilities and the California Public Utilities Commission (CPUC) to ensure that the rate incentives associated with utility-retained generation scheduling are resolved to support the dispatch of the lowest cost energy. Finally, the department should collaborate with market participants to resolve settlement process problems associated with the energy and ancillary services functions that the department conducts on behalf of the ISO.

***Department Action: Pending.***

The department's implementation of our recommendations is being further evaluated with audit 2002-009, which we are scheduled to release in March 2003.

**Finding #4: Many decisions are needed regarding the future role of the State in the power market.**

The governor, the Legislature, and the department need to make many decisions about the future role of the State in the power market. Now that the crisis has eased, the Legislature and the governor should consider how best to serve the power requirements of the State's consumers over the long term and how best to manage the costs and mitigate the risks of the

power contracts. A plan for the State's future role in the power markets is necessary regardless of whether the department continues to manage the program or whether the program becomes a separate state agency or a different type of governmental entity.

The Legislature will also need to evaluate whether to extend the department's responsibilities beyond January 1, 2003, to allow time for present uncertainties that affect these decisions—such as the financial health of the investor-owned utilities and the role of the new state power authority—to be resolved. Other relevant factors that decision makers must consider include the fact that current long-term contracts do not permit the State to renegotiate or quit contracts that become burdensome or unfavorable and whether the department can assign contracts to other entities. Further, the Legislature needs to take into account the ability of the administering entity to protect the interests of power programs before regulatory bodies to minimize regulatory risks. Even though the CPUC and FERC do not directly regulate the department, their actions have substantial bearing on the market within which the department operates, the load and services for which the department is responsible, and the collection of revenue. Thus, the department needs to actively manage the regulatory risks that result from CPUC and FERC actions. In addition, the department still needs authority to enter financial transactions to manage gas and electric transaction risks.

We recommended that the Legislature and governor consider developing a comprehensive, long-term strategic framework for the electricity industry in the State and for the department's role in that system. We also recommended that the Legislature consider extending the department's purchasing authority to allow time for the development and implementation of a strategic framework and to assure continuity of the purchasing authority and an effective transition, presumably back to the investor-owned utilities.

Additionally, we recommended that the department develop a strategic plan for the future of the power-purchasing program, including an assessment of the transition processes needed to allow orderly transfer of functions to the ISO, the investor-owned utilities, and others, as appropriate. The department should also continue its efforts to coordinate work with the newly created power authority to clearly establish their respective roles and responsibilities. In its future efforts to protect the

interests of the power-purchasing program, the department should retain independent counsel to advise it on matters relating to state and federal regulatory issues. Further, the department should perform a comprehensive assessment of its collaboration with the attorney general, the Electricity Oversight Board, the CPUC, and other state entities to ensure that the interests of the power-purchasing program are distinctly and adequately represented in regulatory proceedings. Finally, we recommended that the department seek clear statutory authority to use financial instruments to manage natural gas and electric gas risks.

***Legislative Action: Pending.***

The Legislature's implementation of our recommendations is being further evaluated with audit 2002-009, which we are scheduled to release in March 2003.

***Department Action: Pending.***

The department's implementation of our recommendations is being further evaluated with audit 2002-009, which we are scheduled to release in March 2003.

**Finding #5: The department needs to improve other capabilities in its administration of the power-purchasing program.**

We noted that the department needed to make other improvements in its administration of the power-purchasing program. Specifically, we observed the following:

- Although the department has entered into servicing agreements with the investor-owned utilities, it lacks processes to evaluate their performance in estimating consumer demand for power and the department has not developed procedures for how to exercise its auditing rights or to obtain reports from the investor-owned utilities. In addition, the department and the investor-owned utilities have not agreed to share market data, which would assist the department in carrying out its purchasing function.
- Although the department has taken steps to prevent conflicts of interest among its consultants and has implemented a policy that requires them to file the State's standard form for disclosure of economic interests, its process has not accounted for all consultants working on the power-purchasing program.

- The department's internal controls were not adequate to ensure that all charges to the power-purchasing program were valid. Further, when the department identified errors, it failed to completely correct the errors. For example, we identified approximately 14,300 hours for which department staff worked on the program, but for which no payroll costs were charged to the program. However, the department only corrected charges for approximately 4,300 hours.

To address these concerns, we recommended that the department take the following actions:

- The department should amend the servicing agreements to include language that promotes accuracy in the investor-owned utilities' estimates of consumer power needs. It should also develop audit procedures to monitor the investor-owned utilities' performance of critical elements of the servicing agreements, such as remittance of cash, allocation of the power the department purchases, and the cost of energy conservation programs. The independent auditors of the investor-owned utilities should perform these audit procedures.
- To help ensure that its consultants do not have potential conflicts of interest, the department should continue its efforts to review potential conflicts of interest among all employees and consultants twice each year and retain a record of its review.
- The department should improve its internal controls to ensure that only appropriate costs are charged to the power-purchasing program and that these costs are supported by evidence of service.

***Department Action: Pending.***

The department's implementation of our recommendations is being further evaluated with audit 2002-009, which we are scheduled to release in March 2003.





# DEAF AND DISABLED TELECOMMUNICATIONS PROGRAM

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## ***Insufficient Monitoring of Surcharge Revenues Combined With Imprudent Use of Public Funds Leave Less Money Available for Program Services***

REPORT NUMBER 2001-123, JULY 2002

California Public Utilities Commission's and Deaf and Disabled Telecommunications Program's responses as of September 2002

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

*Our review of the Deaf and Disabled Telecommunications Program (DDTP) concludes that:*

- ☑ *Neither the DDTP nor the California Public Utilities Commission (CPUC) is fulfilling its responsibilities to ensure that telephone companies (carriers) are remitting required surcharges, possibly resulting in hundreds of thousands of dollars going uncollected.*
  - ☑ *Only about 32 percent of certified carriers remitted surcharge payments over the last two years.*
  - ☑ *Some of the DDTP's expenditures are for unreasonable or unnecessary items.*
  - ☑ *The salaries of select DDTP employees average 24 percent higher than those of comparable state positions.*
  - ☑ *Most DDTP contracts we reviewed comply with the Public Contract Code and contain adequate standards for contractors to adhere to.*
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The Joint Legislative Audit Committee requested that we conduct an audit of the Deaf and Disabled Telecommunications Program (DDTP) and California Public Utilities Commission's (CPUC) accounting controls to determine whether they are sufficient to ensure the proper accounting of program revenues and expenditures. We were also asked to assess the DDTP's procedures for ensuring that its contracting practices comply with Public Contract Code and its methods for ensuring that the scope of its contracted work is sufficient, meets the needs of its customers, and is cost effective.

We determined that neither the DDTP nor the CPUC is fulfilling its responsibilities to ensure that telephone companies (carriers) are collecting and remitting required surcharges on intrastate telecommunications charges, possibly resulting in hundreds of thousands of dollars going uncollected. Moreover, the DDTP does not always further its mission when expending public funds, potentially leaving less money available for program services.

### **Finding #1: Neither the DDTP nor the CPUC maintain a reliable record of carriers that are providing services subject to the surcharge.**

Although the DDTP and the CPUC share responsibility for ensuring that all mandated surcharges are remitted to the Deaf Equipment Acquisition Fund (DEAF) Trust, neither entity has a firm grasp on which carriers should be collecting and remitting these surcharges. As of April 2002, the CPUC's list of active carriers—or those currently certified to operate and/or provide telecommunications services in California—totaled 1,483. At least 68 percent of the carriers on the CPUC's active list did not remit surcharge revenue for 2000 or 2001. However,

the CPUC is not sure how many or which of these carriers are actively providing the intrastate services that are subject to the surcharge. Consequently, the CPUC could provide no definitive reason for why these carriers did not remit during the past two years. Some options include (1) they do not provide services subject to the surcharge, (2) they stopped operating before January 2000 or did not begin operating until after December 2001, (3) they do not collect the surcharge from their customers, or (4) they simply do not remit the surcharges they collect. No one knows for sure what the reason is. In any event, it is likely that some, if not many, of these carriers should be submitting surcharge revenue.

We recommended that the DDTP work with the CPUC to develop and maintain a reliable record of carriers that are providing services subject to the surcharge. We also recommended that the CPUC should require that all active carriers that do not submit surcharge revenues certify that they in fact do not provide services subject to the surcharge.

***DDTP and CPUC Action: Partial corrective action taken.***

On August 22, 2002, the CPUC approved Resolution T-16663, transferring from the current staff of the DDTP to the CPUC the responsibility of monitoring and reviewing all DDTP surcharge remittances. To ensure that the CPUC has correct carrier contact information in its telecommunications carriers database, it plans to request carriers to update contact information by sending an e-mail to the CPUC with the changes in contact information. In addition, the CPUC stated that the recommendation to have carriers certify if they did not provide services subject to the surcharge will require a review of various alternatives. The CPUC will report on this recommendation in its six-month response.

**Finding #2: The DDTP does not adequately review or record the payments it receives.**

The DDTP is responsible for reviewing incoming transmittal forms, which detail remittances, and for maintaining an accurate record of payments so it can recognize which carriers have not remitted as frequently as required. Although the DDTP receives transmittal forms, it does little more than a cursory spot check of these forms before filing them away. In addition to not reviewing these forms adequately, the DDTP does not maintain an accurate record of payments or a payment history

of carriers. As a result, it has been remiss in identifying both small and large carriers that have missed payments, potentially resulting in hundreds of thousands of dollars of uncollected funds. For example, the DDTP did not recognize that one large carrier missed submitting a payment for June 2000. As of April 2002, the carrier still had not submitted the payment, which—if similar to subsequent payments—should have been approximately \$200,000. Also, because the DDTP does not maintain accurate records based on the transmittal records it receives, it is unable to investigate potential discrepancies between the information recorded on the transmittal form and that in the DEAF Trust statements provided by the Bank of America, leaving potential errors unspotted.

We recommended that the DDTP track the payment history of each carrier and monitor these records to identify delinquent carriers. Also, beginning on July 1, 2003, the CPUC will ultimately be responsible for ensuring that it collects all surcharges. Thus, the CPUC will also have to monitor payment history records to ensure that carriers are remitting surcharges as required.

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

As previously mentioned, the CPUC approved a resolution transferring all responsibility for monitoring and reviewing DDTP surcharge revenues to itself and anticipates a complete transfer of responsibility by January 2, 2003. Also, the CPUC has submitted a request to the Department of Finance for approval to open a lockbox account to be connected to the DEAF Trust. The lockbox account will enable CPUC staff to receive daily data from the commercial bank listing the collected surcharges remitted to the account and the carriers remitting the surcharge. The CPUC will download the daily data into its public programs surcharge remittance database for review. Finally, the CPUC is drafting an invitation for bid to provide for improvements to its current surcharge remittances database in order to better track the payment history of each carrier.

**Finding #3: The DDTP does not identify late payments or report them to the CPUC.**

The DDTP is to send out past-due notices to carriers when they have failed to remit as required and contact the CPUC concerning all delinquent surcharges. However, the DDTP does not carry out any of these procedures. Although the CPUC has

ultimate enforcement power, the DDTP neither tracks which carriers are late in submitting payments nor confirms that the carriers are remitting the appropriate late-payment penalty. As a result, large amounts of revenue in the form of late-payment penalties go uncollected, and the DDTP has missed out on thousands of dollars of revenue that could be used to provide services to the deaf and disabled communities. For example, one large carrier failed to submit surcharge remittances for September and October 2001. When it finally did so on April 2, 2002—142 and 111 days late, respectively—the carrier did not submit any late-payment penalties, which should have been almost \$31,000.

We recommended that the DDTP regularly notify delinquent carriers and the CPUC of all past-due amounts. We also recommended to the CPUC that it enforce late-payment penalties.

***CPUC Action: Pending.***

As part of its efforts to make database improvements, the CPUC plans to automate its remittance database to routinely create letters to send to carriers who are delinquent in remitting surcharges or have not remitted the correct amount. Also, though the CPUC continues to endorse the enforcement of late penalties, a review of various alternatives is necessary before it fully implements this recommendation. Thus, the CPUC will report on its review of and findings regarding this issue in its six-month update to the Bureau of State Audits.

**Finding #4: The CPUC could improve its oversight of the DDTP and the program.**

The CPUC, despite being the governing body over the program and the DDTP, does not always demonstrate consistent oversight over the carriers or the revenue collection functions performed by the DDTP. For example, the CPUC does not ensure that carriers are following its instructions regarding the collection and remittance of surcharge revenues. Specifically, we found that carriers did not consistently apply the surcharges to the different types of intrastate service charges. In addition, carriers apply different methods when reporting and paying late-payment penalties. This may be occurring because the guidance provided by the CPUC is not detailed enough. As a result, there is a great deal of inconsistency and inefficiency in the surcharge process.

Also, the CPUC is beginning to conduct remittance review audits of various carrier practices and procedures for some of its universal service programs, but it does not do so for the DDTP. Although the DDTP claims it does unofficial “spot reviews” of transmittal forms to ensure accuracy, these reviews pale in comparison to a highly detailed remittance audit. No such formal review has taken place since 1997. Unchecked carrier practices and procedures create the potential for errors that would hamper the DDTP’s ability to carry out its mission.

We recommended that the CPUC rewrite its transmittal form instructions in explicit detail, ensuring consistency among carriers. In addition, the CPUC should conduct periodic remittance audits of DDTP surcharge revenues.

***CPUC Action: Pending.***

The resolution recently passed by the CPUC giving itself sole responsibility for the monitoring of surcharge remittances also includes funding for three carrier remittance audits and one financial audit of the program. The CPUC did not comment on rewriting its transmittal form instructions in more explicit detail.

**Finding #5: The DDTP does not always further the program’s mission when expending public funds.**

The DDTP sometimes spends public funds on items that are unrelated to program services or that do not further the program’s mission. Specifically, the DDTP has spent excessive amounts on food for training sessions, committee meetings, and other events. In addition, many program employees have DDTP credit cards, sometimes charging imprudent expenditures such as gifts and meals. Also, the DDTP has in the past reimbursed employees for expenses typically not permitted in public service, such as moving expenses and temporary rent payments. As a result, less money is available for the individuals it serves. However, the DDTP has initiated corrective action by adopting new policies on allowable expenditures.

To ensure the prudent use of public funds in furtherance of the program’s mission, we recommended that the DDTP adhere to its newly revised internal control procedures that define allowable expenses.

***DDTP Action: Corrective action taken.***

The DDTP has implemented a new policy specifically defining allowable and non-allowable expenses. The DDTP reported that a memo describing the new policy was distributed to all DDTP managers and supervisors and has been implemented throughout the organization.

**Finding #6: The DDTP has not always reported taxable fringe benefits and needs additional controls to prevent personal use of vehicles.**

Previously, the DDTP failed to report to the proper taxation authorities taxable fringe benefits received by some of its employees. These benefits include paid parking and what appears to be personal use of leased vehicles. When we informed DDTP management of this, it began to initiate corrective action, including reporting parking benefits as additional income to the employee. However, the DDTP can strengthen its internal controls to prevent or record and report employees' personal use of leased vehicles.

Thus, we recommended that the DDTP develop additional procedures to prevent personal use of DDTP-leased vehicles. For example, the DDTP should label all its vehicles and require employees to maintain daily log records of miles driven. When personal use occurs, the DDTP should report it as a taxable fringe benefit to the proper taxation authorities. We also recommended that the DDTP follow its new procedures to report parking fringe benefits as taxable income on employees' W-2 forms.

***DDTP Action: Corrective action taken.***

Currently, the DDTP's payroll service reports to the employee and the proper taxation authorities the taxable amount of any parking benefits on the payroll stub of any employees for whom the reporting is required per IRS rules. This reporting is done automatically each payroll cycle. Also, the DDTP has developed and implemented mileage logs, which are now required to be completed by any employee using a DDTP-leased vehicle. Employees have begun to log miles driven and locations visited on a daily basis, and the supervisor compares the mileage logs to the employee's event forms or work order forms on a monthly basis to verify the mileage driven. Finally, the DDTP has also ordered decals for its leased vehicles, which state, "For Official Use Only," along with the DDTP logo.

**Finding #7: Some DDTP contracts lack adequate benchmarks or standards to measure contractor performance.**

Some of the contracts that we tested lacked specific performance standards for contractors as well as provisions for monetary penalties for nonperformance. The fact that the DDTP has expressed some dissatisfaction with some of the services provided exacerbates this problem. Had the DDTP established appropriate service levels, performance measures, and provisions to collect for noncompliance in the original contract, the vendors might have performed at acceptable levels or the DDTP might have collected penalties for their failure to do so.

We recommended that the DDTP ensure that all future contracts have established performance standards as well as provisions to collect damages from nonperforming contractors. Also, the program's administration will undergo some changes over the next year, including the CPUC potentially contracting out for many of the services the DDTP currently provides. Whether the CPUC contracts out for all or some of the day-to-day provision of program services, it should include specific provisions in its contracts that require contractors to comply with state laws, regulations, and policies related to reimbursable expenses. In addition, it should include specific performance standards in its contracts and monitor whether the contractors are meeting those standards. Finally, the CPUC should include provisions in its contracts that will allow it to collect damages from nonperforming contractors.

***DDTP and CPUC Action: Pending.***

The DDTP reports that it has not developed any new contracts since the issuance of our report, but will include the recommended provisions in any future contracts. The CPUC is currently in the process of developing a transition plan for when all DDTP funds are transferred to the State Treasury on July 1, 2003. This plan will include a competitive bidding process to provide the personnel to operate the DDTP. The CPUC states that the competitive bidding process and subsequent contract(s) will adhere to all state contracting rules including requirements related to reimbursable expenses. Proposed contract(s) will include performance measures to be met by contractors and penalties for non-compliance. The CPUC anticipates a final transition plan to be implemented by December 2002.





# DEPARTMENT OF HEALTH SERVICES

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## ***Additional Improvements Are Needed to Ensure Children Are Adequately Protected From Lead Poisoning***

REPORT NUMBER 2000-013, MAY 2001

Department of Health Services' response as of May 2002

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

*Our follow-up audit of the Childhood Lead Poisoning Prevention Program (program) revealed that the Department of Health Services (department) made only limited progress in implementing our recommendations. As a result, the department still:*

- ☒ *Does not ensure California's children identified with lead poisoning receive the proper medical care and are protected from further exposure.*
- ☒ *Is unable to determine the full extent of lead poisoning in California—having identified only about 10 percent of the estimated 38,000 children needing services.*
- ☒ *Lacks the enforcement authority needed to reduce or eliminate lead hazards.*

*Additionally, the department needs to address staffing shortages and projected funding shortfalls to avoid potential cutbacks in program operations.*

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**A**s early as 1986, the Legislature charged the Department of Health Services (department) with determining the extent of lead poisoning among children in the State. In 1991 the Legislature set specific goals for protecting children from lead poisoning; it asked the department to evaluate all children for their risk of poisoning; to test those children who were at risk; to provide case management for children who were at risk; and to provide case management for children who were found to suffer from lead poisoning.

Chapter 540, Statutes of 2000, requires the Bureau of State Audits to report on the extent to which the department has addressed the recommendations made in our April 1999 report. Our follow-up audit of the department's Childhood Lead Poisoning Prevention Program (program) concluded that the department still has made only limited progress in fulfilling its most critical missions related to lead poisoning and has not fully implemented all of our previous recommendations. Specifically:

### **Finding #1: The department does not ensure that local programs follow its case management process.**

The department has failed to enforce case management guidelines for local programs that require them to report all their activities for lead-poisoned children. Additionally, when the required reports are submitted, the department does not review them to ensure adequate services are rendered to children. Without obtaining and reviewing case management information, the department cannot be certain that all lead-poisoned children receive proper care, that the levels of lead in their blood are reduced to safe levels, or that the sources of their lead exposure are reduced or eliminated.

We recommended that the department ensures that local programs submit all case management information outlining the services provided to lead-poisoned children, and monitor local programs' activities to ascertain whether lead-poisoned children receive appropriate care.

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

The department stated that it instituted protocols designed to monitor case management by local programs. The protocols include a review of all follow-up forms submitted by local programs as well as a detailed review of a sample of all forms. The reviews are designed to ensure that all follow-up information on lead-poisoned children is submitted promptly and that the information is complete. Further, the branch has conducted site reviews of local health departments. Although some deficiencies have been noted during the reviews and issues requiring additional guidance and training have been identified, the department reports that most local programs are doing an excellent job. Finally, the department reported that it is revising its follow-up forms and tracking database to improve the tracking of case dispositions.

**Finding #2: The department has not determined where and to what extent lead poisoning is a problem throughout the State and has not adequately identified children with lead poisoning.**

The department has not been successful in its efforts to implement regulations that would require laboratories to report the results of all blood-lead tests. Efficient reporting of all blood-lead tests and their results would provide the department the data it needs to evaluate and report on the nature and extent of lead poisoning among California's children. Implementing these regulations is also critical because current blood-lead reporting requirements do not correspond with the department's more restrictive criteria for providing case management. As a result, the department cannot ensure that all children requiring case management receive these services.

To collect data on where and to what extent lead poisoning is a problem and to ensure that children with elevated blood-lead levels are identified and treated, we recommended that the

department adopt regulations requiring laboratories to report all blood-lead test results and complete the testing and installation of software that will allow laboratories to electronically submit their results.

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

Department-sponsored legislation requiring laboratories to report all blood-lead test results was signed into law in September 2002 and takes effect January 1, 2003 (Chapter 931, Statutes of 2002). However, the department has not completed the testing and installation of software that will allow laboratories to electronically submit their blood-lead test results. The department-sponsored law contains a provision for complete electronic reporting by January 1, 2005.

**Finding #3: The department still needs to design enforcement and evaluation components for statewide screening requirements.**

Although the department has substantially complied with state law and the United States Centers for Disease Control and Prevention's guidance in enacting its screening requirements, it has not incorporated measures to ensure these requirements are effective.

To improve the effectiveness of its screening regulations and state plan, we recommended that the department revise its screening regulations to add an enforcement component and to require all providers to document their reasons for not ordering blood-lead tests on children. We also recommended the department develop a plan to monitor and evaluate its screening regulations and statewide targeted screening policy.

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

The department reported that its revised screening regulations became effective November 19, 2001. In its efforts to monitor compliance with these regulations, the department stated that it has moved forward with its plans for monitoring and evaluating the screening of at-risk children. For example, the department reported that it developed a report to monitor screening practices among managed care plans and that it has instituted chart audits to determine the proportion of children screened.

**Finding #4: The department does not identify and educate Medi-Cal or CHDP providers who fail to screen children for lead poisoning.**

Although the department has taken steps to educate providers of the need to screen high-risk children for lead poisoning, it has been unable to target its educational efforts to those providers who are not ordering blood-lead tests. Both the State and federal government require that all children receiving Medi-Cal and CHDP services receive a blood-lead test; however, less than 25 percent are tested.

To improve the effectiveness of its outreach efforts, we recommended that the department target those providers who fail to comply with the screening requirements.



***Department Action: None.***

The department reported that it has taken no action to improve the effectiveness of its outreach efforts by identifying and educating Medi-Cal and CHDP providers who fail to screen children for lead poisoning. However, it reports that it has increased the reimbursement to all Medi-Cal and CHDP providers for blood tests and counseling as an incentive to increase screening rates.

**Finding #5: Ongoing staffing shortages and lawsuits as well as projected funding shortfalls threaten the department's current level of program operations and its ability to make needed improvements.**

The department's progress in protecting California's children from lead poisoning has been hindered by the lack of adequate staff and by lawsuits that divert the attention of the staff it does have away from its primary mission. Of equal concern, without an infusion of funding, the department is projecting a funding shortfall for the program in fiscal year 2003–04 that would likely result in cutbacks in activities, which are already insufficient.

To ensure that the program is able to adequately protect California's children from lead poisoning, we recommended that the department take the steps necessary to ensure that the program has adequate funding and staffing to achieve its mandates and goals.

***Department Action: Pending.***

The department reported that the Governor's proposed budget for fiscal year 2002–03 includes a \$7.2 million funding increase, which will allow program changes that address our audit recommendations. Specifically, the proposed increase includes funds to implement increased laboratory reporting and enforcement for correction of lead hazards, and to increase permanent and contract staffing levels.

**Finding #6: The lack of explicit enforcement authority limits state and local efforts to reduce or eliminate sources of childhood lead exposure.**

Although the department has conducted numerous training sessions to educate local officials about ways to use existing laws to order and enforce the reduction or elimination of lead hazards, it has been unsuccessful in its efforts to have legislation enacted to strengthen statewide authority in these areas. As a result, local officials and the department may be unable to adequately protect children from lead hazards.

We recommended that the department seek legislation granting the department, cities, and counties the authority to investigate properties with suspected lead hazards and to order and enforce the abatement of lead hazards against property owners. In the absence of this authority, the department should continue its efforts to assist local authorities with issuing and enforcing abatement orders by continuing its training and education efforts.

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

Enacted legislation sponsored by the department (Chapter 931, Statutes of 2002), effective January 1, 2003, clarifies the authority of both state and local agencies to investigate, order, and enforce abatement of lead hazards. Also, the department reported that it has developed a draft enforcement guidance manual for local agencies and will continue conducting training classes for local programs.

**Finding #7: The department remains at risk of losing federal funding for lead hazard reduction and elimination activities.**

The department has been unsuccessful in enacting regulations granting it the authority to impose administrative, civil, and criminal sanctions against those who violate state requirements related to lead-safe work practices. As a result, the department

has failed to comply with the requirements of the Federal Environmental Protection Agency. Until the department addresses these issues, it places the State and local agencies at risk of losing federal funding to support lead reduction or elimination activities.

We recommended that the department seek legislation granting enforcement authority to impose administrative, civil, and criminal sanctions against those violating lead-safe work requirements.

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

The department reported that it sponsored proposed legislation, Senate Bill 406, introduced February 20, 2002, that will allow it to impose administrative, civil, and criminal sanctions for noncompliance with lead-safe work practices and certification requirements. On September 26, 2002, the legislation was enacted as Chapter 931, Statutes of 2002, and became effective January 1, 2003.

**Finding #8: The department has yet to complete a statewide plan for its health care provider outreach efforts.**

In 1996 the department began developing a statewide provider outreach plan to educate providers on the importance of evaluating and testing children for lead poisoning. Although the department has begun to implement some of its provisions, the plan is still in draft and lacks timelines and implementation strategies the department will need to evaluate whether its activities are on target and effective in reaching and educating providers.

We recommended that the department continue its efforts in finalizing and implementing a comprehensive statewide provider outreach plan complete with timelines and implementation strategies.

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

The department stated that the plan is completed and that implementation efforts are underway. Its outreach activities include new outreach materials, Web site accessible information, a media campaign, and provider notification.

**Finding #9: It is too soon to tell whether the department's requirement for local programs to monitor their outreach and education efforts is successful.**

The department now requires local programs to evaluate the effectiveness of their outreach and education efforts in identifying more lead-poisoned children, and it also provides assistance to local programs in developing the proper tools to complete these efforts. However, full implementation and evaluation of these efforts are to occur over a two-year period ending June 30, 2002. These efforts will allow the department to determine which outreach strategies achieve the best results and to share the knowledge with local programs.

We recommended that the department continue its efforts to assist in refining the tools that are currently in place for evaluating the effectiveness of the local programs' outreach and education efforts.

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

The department has received and reviewed the first three biannual progress reports from local lead poisoning programs. The department states that it created a database to track and analyze the information in the progress reports.

**Finding #10: The department developed a comprehensive lead-safe schools program; however, it may not have the funding to fully implement the program.**

In response to a department study that found many schools and day care facilities have lead-based paint or lead in their water, the department developed a curriculum to educate schools and day care staff on the appropriate steps for reducing or eliminating lead hazards. Although it has conducted training at slightly more than half of the school districts targeted for having elementary schools, it will be unable to complete its training efforts before its funding expires.

We recommended that the department pursue the funding needed to complete its lead-safe schools training program in all targeted school districts and to provide follow-up training to these schools as necessary.



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

The department states that it is continuing to fund the lead-safe schools program and renewed until June 30, 2003, its contract to create instructional materials and train school district representatives about lead hazards.

# CALIFORNIA EARTHQUAKE AUTHORITY

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## ***It Has Taken Steps to Control High Reinsurance Costs, but as Yet Its Mitigation Program Has Had Limited Success***

REPORT NUMBER 2000-133, FEBRUARY 2001

California Earthquake Authority's response as of February 2002

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

*Our review of the California Earthquake Authority's (authority) reinsurance costs and State Assistance for Earthquake Retrofitting (SAFER) program disclosed:*

- ☒ *The authority's reinsurance costs are high, but not unreasonable compared to what other companies are paying.*
  - ☒ *The authority has reduced its reinsurance costs by negotiating favorable contract terms and exercising contract options.*
  - ☒ *As of December 2000 only 31 of 3,576 homeowners whose homes needed structural retrofits had made them.*
  - ☒ *The remaining backlog of seismic inspections and assessments should be completed and mailed to homeowners by mid-May 2001.*
  - ☒ *The authority has spent \$3.5 million on SAFER, which is within its statutory requirement.*
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The California Earthquake Authority's (authority) reinsurance costs in 1998 represented 90 percent of its policyholder premiums, prompting the Joint Legislative Audit Committee (audit committee) to request that we determine whether the total annual expenditures for reinsurance and capital market contracts constitute a reasonable and appropriate percentage of the authority's annual collected premiums. The audit committee also asked us to examine the authority's implementation of its State Assistance for Earthquake Retrofitting (SAFER) program, an earthquake mitigation pilot program, which is currently in its second phase. We found that:

### **Finding #1: The authority's high rate in 1998 was due to one-time factors.**

In 1998 the authority's rate (the percentage of policyholder premiums it spent for reinsurance) was 90 percent, according to its audited financial statements. This was due primarily to reinsurance costs that were not allocated evenly over the life of its original two-year contract for the first \$1.4 billion of reinsurance coverage. The authority's member companies had existing earthquake policies that would be converted to authority policies over the course of its first year of operation. During that year, the authority's exposure level gradually increased until it reached its full amount when the conversion was complete. Therefore, the payment schedule was set up to reflect the fact that the authority would have considerably more risk to cover in 1998 than it had in 1997. Additionally, the contract for the remaining \$1.1 billion of reinsurance coverage required the authority to pay for two years of coverage in calendar year 1998. Therefore, although the authority's 1998 rate seems alarmingly

high, this rate is due primarily to a high reinsurance premium split unevenly over a two-year contract and a required up-front premium in the second contract.

**Finding #2: The authority's capacity to pay claims relies heavily on costly reinsurance.**

The authority maintains roughly \$2.5 billion in reinsurance coverage, which makes up about one-third of its capacity to pay policyholders in the event of an earthquake. Because catastrophe reinsurance is more expensive than other types of reinsurance, and because the authority must offer earthquake insurance to all qualified homeowners throughout the State, the reinsurance it purchases is costly. The authority's reinsurance costs are higher than other insurance companies because of its unique restrictions. By law, it must offer earthquake coverage statewide, so it cannot reduce its exposure to loss by limiting coverage in geographic areas that are highly prone to earthquake damage.

**Finding #3: The authority has taken steps to reduce its reinsurance costs while maintaining the required amount of reinsurance coverage.**

According to its lead reinsurance intermediary, hired by the authority to negotiate its reinsurance contracts, the rate-on-line (the amount of compensation the authority currently pays to reinsurance companies to assume part of its risk) is not unreasonable compared to what other companies are paying.

Nevertheless, the authority has negotiated with its reinsurers to reimburse a portion of the premiums on the first layer of reinsurance if they sustained no losses under the contract for calendar years 1997 through 1999. This, coupled with a reinsurance premium adjustment due to the authority's exposure falling below 90 percent of \$203.6 billion, resulted in a reinsurance refund of nearly \$82 million for its first three calendar years. The authority is also attempting to lessen its reliance on reinsurance by following the advice of its consultant to reduce the amount of coverage it buys and by testing its ability to transfer some of its earthquake risk into the capital market.

**Finding #4: The authority faces critical challenges in the future.**

The primary challenge that the authority faces is in maintaining its claims-paying capacity. Its reinsurance contracts will expire in the next two years and its authority to assess its member companies up to \$2.2 billion when losses exceed its capital will expire in December 2008.

To ensure that it maintains its claims-paying capacity, we recommended the authority continue to monitor the reinsurance market and research alternative financing to reduce its dependence on reinsurance.

***Authority Action: Corrective action taken.***

The authority reported that its governing board and staff continue to look for ways to reduce the costs of risk transfer in general and reinsurance in particular. For example, one proposal is to purchase less reinsurance in 2003 than in previous years. In addition, the authority's staff continues to monitor, research, and discuss with its governing board, various alternative financing methods such as catastrophe bonds. Following the events of September 11, 2001, and anticipating insurance and reinsurance market disruptions, the authority formed a high-level reinsurance task force to monitor closely the fast changing market developments. The authority plans to continue to draw on these experts to monitor reinsurance pricing and market conditions.

**Finding #5: The authority has not yet captured sufficient data to assess the State Assistance for Earthquake Retrofitting (SAFER) program's effectiveness in achieving retrofits.**

The authority has not yet found an effective mix of incentives to encourage homeowners to retrofit their homes, and the number of homes that have been retrofitted is low. Thus, although the authority has spent approximately \$3.5 million for the SAFER program, it cannot demonstrate it has achieved its ultimate goal of reducing the State's risk of personal and business economic loss from earthquakes. As of December 8, 2000, only 31, or 0.9 percent, of 3,576 homeowners whose homes needed structural retrofit improvements had completed the needed improvements through the SAFER program. Another 54 homeowners had begun the retrofitting process, but the work

was not complete. A telephone survey in January 2001 of 300 homeowners who participated in the SAFER program needs more analysis before the authority can use it to estimate how many other homeowners who received seismic assessments through the SAFER program made some or all of the necessary improvements but did not report them.

**Finding #6: The authority has reduced the backlog of seismic assessments for homeowners.**

Between October and December 1999, after a great deal of media attention, the SAFER program received nearly 17,000 telephone calls from interested consumers, resulting in 8,304 qualified homeowners interested in receiving a seismic assessment of their homes. To meet this unexpected demand and the resulting backlog of inspections, the authority increased the number of engineering firms that conduct the inspections and prepare assessment reports. As of early December 2000, the authority had spent about \$3.5 million for its earthquake mitigation program, had completed roughly 68 percent of the home inspections, and had sent 86 percent of these homeowners their assessment reports. According to the authority, the remaining inspections and assessment reports should be complete and mailed to homeowners by mid-May 2001.

To ensure that the goal of the mitigation program is achieved, we recommended the authority establish a system for determining how many homeowners who participate in the SAFER program complete the recommended retrofit improvements. The authority should also establish a target number of homes to be made seismically secure so it can demonstrate that the goal of the program has been achieved. Until these elements are in place, the authority should delay expanding the program.



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

The authority is redesigning its SAFER program database to provide the capability of tracking and monitoring the status of individual homeowners in the retrofit process. Database modifications are being made so that projects can be sorted in a variety of ways, which the authority states will allow it to better monitor and track each retrofit improvement. The water heater program is currently using the new features of the database and a full conversion will be completed before any new SAFER program is launched. Further, the authority states that after the SAFER program completed 7,117 assessments, it

conducted a thorough analysis of program participants, which allowed it to better understand the actions program participants did or did not take following their SAFER assessment.

As of February 28, 2002, the authority had not established a target number of homes to be made seismically secure by which it can demonstrate that the goal of the program has been achieved. However, the authority is exploring options to include public and private partnerships to expand the reach and effectiveness of the mitigation program. Assuming that additional funding from other sources is secured, the authority's goal over a two-year period is to educate 20,000 single family homeowners as to their seismic risk and motivate them to take action.

To further encourage homeowners to protect their homes from the peril of earthquakes, we recommended the authority continue to research why more homeowners who received assessment reports have not followed through with retrofitting their homes. Once the authority identifies the reasons, it should make appropriate changes before expanding the program.

***Authority Action: Corrective action taken.***

To encourage more homeowners to retrofit their homes, the authority has elected to enhance the SAFER program by narrowing its requirements to focus on single-family homes that can most benefit from seismic retrofitting. In addition, the program will continue to offer free preliminary seismic assessment reports, but will also significantly subsidize other steps in the retrofit process, which should encourage more homeowners to retrofit their homes. For example, the homeowner will pay \$250 for engineering plans while the SAFER program pays the remaining \$200. The SAFER program will also pay 15 percent of the costs, up to \$1,800 of actual retrofit construction and the final verification report.

We also recommended that the authority continue to use the information in the SAFER database to develop a strategy to increase the number of retrofits performed as a result of the SAFER program.

***Authority Action: Corrective action taken.***

The authority states that it conducted a thorough analysis of program participants and now better understands why program participants did or did not make the retrofit improvements recommended in their seismic assessment reports. The authority found that more people in the water heater program declined rather than accepted additional assistance to retrofit. As a result, the authority concluded that mitigation funds could be more effective if spent offering a new program to people with a stated interest and desire to retrofit. The authority will continue to work with homeowners who participated in the pilot program who have a desire to retrofit, but will be looking for homeowners in the San Francisco Bay Area who were unable to participate in the initial pilot program. In addition, the authority will continue to track participants as a means of determining what motivates homeowners to retrofit.

Finally, we recommended that the authority pursue clarification of its enabling statute to determine whether its limit of 25 staff includes those who work solely on the earthquake mitigation program or whether the program's staff are in addition to the 25 staff the authority is allowed.

***Authority Action: Corrective action taken.***

The authority plans to contract for more assistance in running its earthquake mitigation program and expected to hire an assistant for the program's manager by March 2002. Further, the authority's governing board has authorized staff to pursue legislation that would re-examine the statutory cap on the number of authority employees. As of February 28, 2002, legislation related to the authority was awaiting amendments and deliberation in conference committee. Additionally, the governing board agreed to retain the services of a registered lobbyist as needed in 2002.

# DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT

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## ***Poor Administration of Certain Aspects of the California Natural Disaster Assistance Program for Loma Prieta Earthquake Victims Could Result in Inappropriate Loan Forgiveness***

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

*We reviewed California Natural Disaster Assistance Program (CALDAP) loans provided to victims of the Loma Prieta earthquake by the Department of Housing and Community Development (department) and found that:*

- ☒ *Despite borrower allegations concerning the quality of repair work, state and local jurisdictions generally provided adequate oversight.*
  - ☒ *The processes used by some jurisdictions may have caused a few borrowers to believe they were not allowed to select their own contractors.*
  - ☒ *By not sending periodic loan statements, the department may have contributed to some borrowers' confusion regarding their loans.*
  - ☒ *The department has not been diligent in monitoring compliance with forgiveness requirements, thereby increasing the risk that some part of \$15.6 million in loans will be inappropriately forgiven.*
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**REPORT NUMBER 2000-129, MAY 2001**

**Department of Housing and Community Development and cities of Berkeley and Oakland's responses as of May 2002**

The Joint Legislative Audit Committee requested that we review the Department of Housing and Community Development's (department) administration of its California Natural Disaster Assistance Program (CALDAP) for victims of the Loma Prieta earthquake. After the earthquake in October 1989, the department loaned approximately \$87 million to more than 900 borrowers to repair and rehabilitate damaged or destroyed single-family dwellings and rental housing. We found that:

### **Finding #1: Despite complaints concerning the quality of repair work, state and local jurisdictions generally provided adequate oversight.**

The CALDAP homeowner loan program provided loans to homeowners in need of assistance. However, nearly 45 percent of the homeowner borrowers in Berkeley and Oakland have alleged various problems. Some of the complaints date to the early 1990s when the repair work was completed, and relate mostly to poor workmanship by contractors. We found that the validity of these complaints varied. For instance, some borrowers have stated that the work performed on their homes was unsatisfactory or incomplete, and some said that rehabilitation inspectors did not appropriately perform their jobs. In fact, a few homeowners have succeeded in recovering damages from contractors through legal action. However, based on the available documentation, we found that for the most part, the local agencies administering CALDAP had adequately overseen repairs and inspections.



In an effort to assess the complaints of poor workmanship, Oakland's Community and Economic Development Agency and Berkeley's City Manager's Office have performed recent inspections of some of the properties in their jurisdictions. Although these inspections have found that many of the complaints are not related to the original CALDAP repair work, some of the complaints have merit.

We recommended that the cities of Berkeley and Oakland continue to provide a process to investigate and evaluate the complaints of CALDAP borrowers.

***Cities of Berkeley and Oakland Action: Partial corrective action taken.***

Since November 2001, the city of Berkeley (Berkeley) has solicited proposals from two private, construction investigation firms to determine how much it will cost Berkeley to conduct new inspections to develop cost estimates for repairs to the homes of CALDAP homeowners. Any new efforts conducted by Berkeley staff are subject to funding allocations by the Berkeley city council. In June 2002, Berkeley staff will make an initial request to fund the construction inspection work. In addition, Berkeley is investigating numerous complaints about the workmanship of various contractors. One contractor in particular received numerous complaints and, after its investigation, Berkeley plans to pursue redress through the Contractors State License Board.

In February and May 2002, the city of Oakland (Oakland) sent out mass mailings to CALDAP homeowners with outstanding loan balances. The mailings contained contact information, including a listing of all city resources for which the homeowners might be eligible, to aid in remedying certain construction failings or additional structural rehabilitation. Oakland has also developed a database of all loan recipients with outstanding balances, as well as those who have submitted complaints. It has assigned two staff members to investigate and conduct site visits as homeowners request them. The Oakland staff maintain a communication log for all complaints received, including action taken.

**Finding #2: Some borrowers felt limited by the contractor selection process.**

A number of borrowers have alleged that they were not allowed to choose the contractors who worked on their homes. We found that the contractor selection processes varied among the local jurisdictions we contacted. Some jurisdictions involved potential borrowers in the contractor selection process more effectively than others. The seemingly restrictive selection process used by some jurisdictions may have resulted in a few borrowers believing that they had to use a specific contractor or were not allowed to select their own. However, we did not find any documentation in loan files to support borrowers' allegations that they were directed to select particular contractors.

To ensure that future loan programs better achieve their goals, we recommended that the department reassess its guidelines and standards of operation for local jurisdictions in areas such as contractor selection and oversight of work quality.

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

In its initial response to the report, the department agreed that the program design of CALDAP had shortcomings. It also noted that it has not used this program design in its more recent programs.

**Finding #3: The department does not provide periodic loan statements.**

The department may have contributed to some borrowers' confusion regarding their CALDAP homeowner loans by not sending periodic loan statements. Except for a statement of final indebtedness following the payment of all anticipated CALDAP rehabilitation expenses, the department has not provided borrowers with periodic statements of their increasing total indebtedness as interest accrues on their loans. Consequently, some borrowers believed their loans were actually grants while others did not fully understand loan repayment terms or refinancing restrictions.

We recommended that the department provide periodic loan statements to borrowers that include outstanding principal and interest amounts and specific contact information for borrowers with questions.

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

The department reported that it sent annual loan balance statements to CALDAP borrowers beginning in January 2002. In addition, the department sent letters to all borrowers on June 12, 2001, reminding the borrowers of the CALDAP loan and providing information related to department contacts.

**Finding #4: Repayment terms of CALDAP loans may cause hardship for the heirs of some low-income borrowers.**

Some provisions of the CALDAP owner loans may result in difficult repayment situations for the heirs of a small portion of the program's borrowers. The terms of CALDAP homeowner loans specify that loan repayment is not required until ownership of the repaired property is transferred or the property is no longer the borrower's principal place of residence. For example, when a borrower dies, California law and the terms of the promissory note prohibit the loan from being assumed except by the surviving spouse, which means that any other heir must repay or refinance the loan to inherit the property. However, in some cases, the heirs may not have sufficient financial assets to repay or refinance the loan. If, for instance, the heirs are disabled or dependent adults, the department should have a method to determine, on a case-by-case basis, the action it believes is in the best interest of the State.

We recommended that the department review and evaluate its existing policies addressing the repayment of homeowner loans to ensure that its policies adequately address difficult repayment situations. If the department determines that a revision of these policies or procedures is, in certain limited circumstances, in the State's interest, it should pursue a statutory revision to allow it the needed operational flexibility.

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

The department reported that it has developed guidelines for decisions regarding forbearance on the foreclosure or other enforcement of CALDAP loans to maximize repayment of public funding while avoiding undue hardships. Because CALDAP operates under guidelines, the department did not undertake revisions to any of its statutes. The department also indicated that its current policy is for departmental management to review decisions to forebear and these decisions are documented in each loan file.

**Finding #5: The department's monitoring of CALDAP rental loans has been lacking.**

The CALDAP rental loan program assists owners and tenants of rental properties. For this reason, CALDAP rental loan borrowers are required to comply with certain rent restrictions, and if these borrowers also restrict units to low-income tenants for at least 10 years of their loans, the State will forgive the rehabilitation portion of their loans. Yet the department did not establish a process to monitor its rental loan borrowers until mid-1996, four years after most of the rehabilitation work had been completed. This delay was despite the statutory requirement that borrowers requesting loan forgiveness comply annually with specific performance conditions for rent and tenant-income levels. Moreover, the department has not always enforced consistent minimum levels of compliance. In addition, the department's guidelines require that assisted units of properties with refinancing loans comply with rent restrictions for the entire length of the original loan. However, we found two loans during our review where funds were used for refinancing but that the department is not monitoring to ensure compliance with the required rent restrictions. Thus, low-income tenants in those facilities for which the owners had opted for forgiveness had no assurance that they were provided the low-cost housing mandated in the statutes.

Further, the department has not been sufficiently diligent since it began monitoring compliance with the terms of rehabilitation loans in 1996, thereby increasing the risk that some part of the \$15.6 million in eligible loans may be forgiven even though some borrowers may not have complied with the required terms. The department has not maintained sufficient documents in its files to verify compliance, and supporting data from loan files has not always agreed with the summary records that the staff prepares and provides to the program's managers.

We also found that the department incorrectly applied maximum allowable rent rates. Moreover, the department has classified some borrowers as conditionally compliant despite the fact that they left units vacant for years at a time or charged rents in excess of the maximum allowable. However, in these cases, it is unclear whether the department will require the borrowers to repay a portion of their loans for the noncompliant years. By granting these borrowers greater latitude than statutory provisions allow, the department may ultimately forgive portions of loans that are not eligible for forgiveness.

To strengthen the process by which it monitors borrowers with rental loans, we recommended that the department take the following steps:

- Ensure that minimum levels of compliance are specified in writing and are sufficiently detailed in accordance with underlying statutes and guidelines.
- Monitor all applicable borrowers—both those that are pursuing loan forgiveness and those that received funds for acquiring property or refinancing—to ensure they meet the terms and conditions of their Regulatory Agreements.
- Retain documents such as periodic status letters, correspondence, and borrower disclosure information of rent and tenant-income levels in borrowers' files to verify compliance with loan forgiveness conditions.
- Provide sufficient annual feedback to allow monitored facilities to correct noncompliant activities. The department should allow conditional certifications only when borrowers agree to correct noncompliance, such as by refunding tenants' overpayment of rents.
- Ensure that future calculations of maximum allowable rent are applied in the appropriate year. The department should also establish status tracking work sheets for all borrowers with rental loans pursuing forgiveness and borrowers with acquisition or refinancing loans.

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

The department reported the following status of its implementation of the recommendations:

- By May 1, 2002, the department has updated its CALDAP desk manual to provide staff with more thorough detail regarding acceptable minimum levels of compliance.
- The department has identified the type of monitoring required by all loans in its CALDAP portfolio. On October 22, 2001, the department sent letters to borrowers of all three types of CALDAP rental loans restating their obligations to maintain rents and occupancy in accordance with their regulatory agreements. The letters included forms and certifications to be completed and returned to the department.

- The department has developed policies concerning the term of affordability required to qualify for loan forgiveness. After the policies were documented, the department's legal affairs division reviewed them for consistency with CALDAP and approved them. The department believes this approach provides clearer legal guidance than does a legal opinion.
- The department's program managers have issued written instructions to staff concerning the retention of correspondence and documents in the borrower files.
- The department has adopted loan forgiveness policies and procedures, which include a process to resolve noncompliance issues. On or before May 1, 2002, and annually after that, the department will provide a certification letter to all borrowers who are seeking loan forgiveness.
- The department has adopted a Rent Increase Policy and a policy entitled "Calculation of CPI Rate of Increase," both of which are applicable to CALDAP rental loan program rents. The policy provides direction for calculating maximum allowable rents. The department has also developed an electronic spreadsheet that ensures consistent application of the appropriate rent increases. In addition, CALDAP program staff have determined that the department's computer database is capable of incorporating loan forgiveness data fields as well as data fields to record information about borrowers with acquisition or refinancing loans. These necessary enhancements are included in the department's annual work plan and are being implemented during fiscal year 2001–02. Meanwhile, electronic spreadsheets, which facilitate the submittal of operating budgets and rent increase requests, are currently available to CALDAP borrowers and management agents.



# CALIFORNIA NATIONAL GUARD

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

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

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

- ☑ *The Army Guard's ability to perform state missions may be compromised by a shortage of qualified aircraft mechanics and delays in receiving helicopter parts.*
  - ☑ *The Army Guard does not ensure that personnel readiness reports exclude ineligible troops; however, because the Office of Emergency Services typically does not request full troop strength, the Army Guard's personnel readiness has no bearing on its ability to assist the State.*
  - ☑ *The Guard needs to make certain that personnel in its Joint Operations Center who coordinate the Guard's state mission response receive requisite training.*
  - ☑ *The Guard does not annually review and update its various emergency plans nor ensure that it implements recommendations from past mission assessments.*
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**REPORT NUMBER 2001-111.2, FEBRUARY 2002**

**California National Guard's response as of August 2002**

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

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

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



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

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

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

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

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

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

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

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

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

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

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

The Guard did not address our recommendation that it should set a standard for using full-time flight facility personnel in fire-fighting missions. Instead the Guard believes that its aviation commanders and its Emergency Operations Center work toward maintaining a balance of full- and part-time aircrew members during state emergencies to accommodate everyone and to assure safe missions. The Guard noted that this is an ongoing process that it will closely monitor.

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

Contrasted with the aviation capability for state missions, the Army Guard's personnel readiness affects only the federal need for troops. In a quarterly USR, each Army Guard unit reports its personnel status by comparing available strength levels, or staffing, against wartime requirements. However, the Army Guard lacks an effective process to ensure that a unit includes only

eligible soldiers in its strength levels. For example, the three Army Guard units we reviewed erroneously included at least 21 soldiers in their combined USRs. Therefore, these units may have overstated their personnel strength levels, or P-levels, making it appear as though they are more ready for war or other federal duties than they are.

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

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

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

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

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

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

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

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

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

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

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

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

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

The Guard should do the following:

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

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

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

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

The Guard's emergency plans guide its response to disasters such as fires, floods, and earthquakes. Although the NGB requires the Guard to review and update these plans annually by September 30, the Guard does not have a process to ensure that this takes place. In fact, the Guard revised only 3 of its 13 plans in calendar year 2001. The director of Plans, Operations, and Security points to high staff turnover and vacancies as reasons for the delays. Without ensuring the revisions are completed, however, the Guard cannot guarantee that its plans contain up-to-date and effective responses to disasters.

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

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

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

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

We reviewed After Action Reports (AARs) relating to various types of large-scale state emergencies, such as the 1992 Los Angeles riots, the 1994 Northridge earthquake, and various flood and wildfire seasons. After completing each mission, the operations center performed a formal assessment of the Guard's performance and typically identified problems and made recommendations on how the Guard could improve its state mission response. Specifically, the AARs for three missions between 1996 and 1998 indicate that at the start of each mission, the Guard should work with the Office of Emergency Services to negotiate an exit strategy that includes clearly defined criteria for extracting the Guard from a mission. NGB regulations require

the Guard to terminate its military support to civil authorities as soon as possible after civil authorities can handle the emergency. Without establishing an exit strategy at the start of each mission, the Guard's crews could remain active longer than necessary, performing tasks that other entities could be doing.

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

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

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

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

The Guard commented that it updated its SOP manual to include establishing an exit strategy at the start of each mission. The Guard stated that it plans to carry out its exit strategies by coordinating with the Office of Emergency Services and monitoring daily situation reports during state emergencies. The Guard stated that it also updated its SOP manual to require tracking of AAR recommendations. Finally, the Guard reported that it completed its management study in June 2002, and is in the process of procuring a computerized tracking system. The Guard expects the system to be in place October 1, 2002, and fully integrated during 2003.

# DEPARTMENT OF REHABILITATION

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## ***The Business Enterprises Program for the Blind Is Financially Sound, but It Has Not Reached Its Potential***

REPORT NUMBER 99020, JUNE 2001

Department of Rehabilitation's response as of June 2002

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

*The Department of Rehabilitation could improve its fiscal administration of the Business Enterprises Program for the Blind (program) by:*

- ☒ *Preparing a comprehensive business plan to better monitor and prioritize the use of its program resources.*
  - ☒ *Better identifying, pursuing, and collecting vending machine commissions.*
- 

As required by the California Welfare and Institutions Code, we conducted a fiscal audit of the Department of Rehabilitation's (department) Business Enterprises Program for the Blind (program). This, our third and final fiscal audit of the program, found that the Vending Stand Fund (vending stand fund) and the Vending Machine Account (vending machine fund) are financially sound. Each fund adequately provides for the program's needs and for the blind participants' pension plan. Nevertheless, the department could improve its fiscal management of the program by developing a comprehensive plan outlining the program's growth and by pursuing more actively the vending machine commissions that support the participants' pension plan. Specifically, we found:

### **Finding #1: The department could benefit from a comprehensive business plan outlining future fund use.**

The program could benefit from a comprehensive business plan outlining the program's growth and the department's plans for the vending stand fund's reserves. The vending stand fund's assets exceeded its liabilities by approximately \$3.8 million, of which \$2.1 million—called a surplus—is available for future program purposes. However, the department has not prepared a comprehensive business plan demonstrating that its proposed uses for this surplus are appropriate and feasible. By developing such a plan, the department could better monitor and prioritize its use of this surplus.

We recommended that the department complete its strategic plan, including a component that outlines its proposed uses of the vending stand fund surplus, which will help the department determine whether the surplus is appropriate for future program needs.



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

The department stated that it completed a strategic plan for the program, including a three-year fiscal plan that will enable program management to improve overall planning for and management of its use of the vending stand fund.

**Finding #2: The department could do more to collect additional vending machine commissions.**

The department could increase vending machine income by identifying additional state and federal locations in which to install machines and by pursuing commissions from vending machine operators or agencies that have failed to remit these commissions. Although the department asserts that it lacks the resources needed to pursue and collect commissions adequately, we found that other states have composed their statutes to allow the use of certain vending machine commissions to help administer the program. The department's failure to collect all available vending machine commissions has a direct impact on the blind vendors' pension plan, to which a majority of these funds are allocated.

We recommended that the department complete its survey of state and federal properties to identify sites for additional vending machines. Additionally, it should identify and pursue the collection of vending machine income from agencies and vending machine operators that refuse or fail to remit commissions and should verify the status of entities that claim they are exempt from having to remit vending machine commissions. Finally, to address its staffing needs, the department should evaluate whether it should redirect staff from other units, contract for professional services, or possibly seek legislation to amend state law so that the department can use some of the vending machine commissions for the hiring of staff.

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

The department stated that it completed the survey process and identified only five locations that it considered feasible for development. The department reported the survey results to the Legislature and the California Vendors Policy Committee in March 2002.

Regarding the pursuit and collection of vending machine commissions, the department's position related to commissions from the California State University system remains unchanged. The department believes that it has met its obligation to pursue commissions from the university system and has taken all reasonable steps to ensure compliance. In its response to our September 12, 2002, report, *Department of Rehabilitation: Its Delay in Correcting Known Weaknesses Has Limited the Success of the Business Enterprise Program for the Blind*, the department stated that it began pursuing past-due commissions in July 2002. However, we found that at that time it did not have a sufficient plan and it could not estimate the amount of past-due commissions.

The department also noted that it contracted with a consultant to develop a database system that will enable it to track and follow up on delinquent commission payments by August 2002. However, as we reported in our September 2002 report on this program, this system was inadequate to track the commissions. As of November 2002, the department reported that it still intends to improve the collection of past-due commissions. The department further indicated that it would seek to reestablish communication with the California Highway Patrol to resolve the issues related to collecting and remitting vending machine commissions as required by law. The department expected to resolve this issue in June 2002. However, as we reported in our September 2002 report on this program, the department currently is not actively pursuing the collection of commissions from potentially exempt organizations.

In addressing its staffing needs, the department asserted that it completed its strategic plan for the program and determined that due to budget reductions and the current hiring freeze, it has no additional staff resources to devote to the vending machine unit. However, it believes it will be able to maintain the vending machine database with its current staff and the assistance of a consultant. The department continued to investigate the feasibility of procuring the services of a private contractor to administer and collect the vending machine commissions and expected to reach a decision by August 2002. As disclosed in our September 2002 report on this program, the department was still reviewing the feasibility of this option, but had missed its initial August 2002 deadline to make its decision. Finally, the department reported that it would be imprudent to consider changes to state law

that may conflict with federal law without formal written agreement from the federal government regarding the use of commissions from machines on state property for administrative staff. However, the department did not indicate whether it had sought this written agreement from the federal government.

# DEPARTMENT OF CORRECTIONS

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## ***Though Improving, the Department Still Does Not Identify and Serve All Parolees Needing Outpatient Clinic Program Services, but Increased Caseloads Might Strain Clinic Resources***

REPORT NUMBER 2001-104, AUGUST 2001

Department of Corrections' response as of August 2002

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

*Our review of the Parole Outpatient Clinic Program (program) at the Department of Corrections (department) found that:*

- ☒ *The program's new continuum process, while an improvement over its previous process, still does not identify and serve nearly 40 percent of mentally ill parolees.*
- ☒ *In 38 of the 83 cases we reviewed, social workers did not perform prerelease assessments, and 45 parolees were not seen by the clinics within required time frames.*
- ☒ *A new data management system, when implemented, may address some of the program's weaknesses, but it would be more effective if linked to other department computer systems.*

*continued on next page*

**T**he Joint Legislative Audit Committee requested that we review and evaluate the goals of the Department of Correction's (department) Parole Outpatient Clinic Program (program) and determine whether the department has adopted reasonable strategies to achieve these goals. The program serves parolees who have mental health needs as well as other parolees who can benefit from psychiatric treatment, such as sex offenders or violent offenders. These parolees receive treatments, including individual or group therapy and medication management, as determined necessary by the program's clinical staff. We found that the program has failed to serve many of the parolees that the department has determined could most benefit from its services. Specifically:

### **Finding #1: The department has failed to identify and treat a large number of parolees who had been diagnosed as mentally ill when in prison.**

Although the program's recently implemented Mental Health Services Continuum Program (continuum process) has increased the proportion of mentally ill parolees it serves, a significant number are still not served. Additionally, the continuum process originally did not include inmates receiving inpatient Department of Mental Health treatment or participating in the Crisis Beds program, both of which include the more severely mentally ill, and therefore may pose a more significant risk to the public. However, the program advised us that it will amend its process to include inmates in these categories. The program has also developed a new data management system that it believes will allow it to better identify and serve all mentally ill parolees. However, the program estimated that this system would not be operational until the end of August 2001.

- ☑ *One-third of the parolees served by the program are not diagnosed with a mental illness but fit other criteria established by the department.*
  - ☑ *The program should establish caseload standards and use its new system to identify its cost of serving different types of parolees so it can manage expected caseload increases.*
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Before October 2000 the department relied on parole agents to refer parolees for evaluation and treatment. This process was not effective, and almost half of the nearly 24,000 mentally ill parolees that went on parole between July 1998 and September 2000 received no treatment at the parole outpatient clinics (clinics). Although the program implemented the continuum process for inmates scheduled for parole on or after October 1, 2000, it still failed to serve almost 40 percent of the more than 6,000 mentally ill parolees who went on parole between October 2000 and March 2001. This is far short of its goal of serving all mentally ill parolees.

We recommend that the program complete the implementation of its new data management system. After implementing the system, the program should identify parolees whom it failed to identify as needing services and ensure that they receive the treatment they need. In addition, it should implement its plan to include in its continuum process those parolees designated while in prison to have been in the Department of Mental Health inpatient and Crisis Beds programs.

To determine the progress the program has made in identifying and serving mentally ill and other parolees, the department should reassess the program one year after implementing the new data management system. The department should submit the completed assessment to the Youth and Adult Correctional Agency.

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

In its one-year response, dated August 29, 2002, the department stated that its new data management system has been fully implemented and is being utilized throughout the State. Additionally, the department stated that its parole agents continue to review parolee records to refer to the program those parolees who were classified as mentally ill while in prison but who have not been evaluated by program personnel. The department also stated that since January 2002, it has included inmates from the Department of Mental Health inpatient and Crisis Bed programs in its prerelease assessments. Finally, the department reported that effective July 1, 2002, it has contracted with the University of California, Los Angeles, to provide a comprehensive independent evaluation of the program.

**Finding #2: The program does not always perform needed prerelease assessments or provide timely services.**

As part of the continuum process, the department established guidelines requiring all inmates diagnosed with mental illness to be assessed before leaving prison on parole and that the parole clinics should see the newly released parolees within specified time frames. However, the program did not complete prerelease assessments for 38 of the 83 mentally ill parolees whose cases we reviewed, even though it had determined that these assessments were needed to properly identify and serve the inmate once on parole. Additionally, program clinicians saw 45 of these 83 parolees outside of the time frames the department has established in order to ensure that mentally ill parolees receive the treatment needed to protect the public and the parolees themselves. In 28 of these 45 cases, parolees were seen within 30 days after parole, but for the other 17, initial appointments did not occur until between 32 to 119 business days after parole.

We recommended that the program use its new data management system to monitor its contractors to ensure that they complete prerelease assessments on all mentally ill inmates scheduled for parole and that its clinics see mentally ill parolees within required time frames.

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

The program has assigned a program manager to monitor the contractors' performance in completing prerelease assessments. In addition, the program is using the new data management system to track the status of prerelease assessments of mentally ill inmates who are within 90 days of release from prison. In its one-year response, the department asserted that 83 percent of all prerelease assessments are now completed on schedule. Further, the department expects this figure to increase as its contractor fills staff vacancies and the program's listing of monthly inmate release dates is improved. Finally, the department has designed the system to ensure that its clinics see parolees within required time frames and has dedicated staff to ensure that this occurs.

**Finding #3: The program's process for identifying parolees that need its services is not always effective.**

Each month, the department provides the program with a list of mentally ill parolees due for parole within the next 120 days. The program then assigns each of the parolees on the list to a

social worker, who then enters the information from their assessment onto the system. However, according to the program, the computer program developed to extract the information from the department's systems did not include all specified mentally ill inmates, so the lists the department produced for the program were incomplete. Indeed, using this process, the program failed to identify and serve almost 39 percent of mentally ill inmates beginning parole terms between October 2000 and March 2001. At least part of this was due to problems identifying all mentally ill inmates about to be paroled.

Linking the program's new data management system to other department systems could improve its efficiency. We believe that if the program automated this exchange of information between the department's systems and the program's new system, it could provide more timely and complete information to the program, reducing the chances of its failing to identify inmates, and therefore, not providing them with needed services.

To more effectively identify all the parolees the program will serve, the program should link its new system to other department computer systems containing the information needed to do so.

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

In its one-year response, the department reported that it has begun sharing data from other departmental systems as recommended by our report. Additionally, the program reports that it will be using information from its newly created Mental Health Tracking System to generate more comprehensive and effective listings of inmates scheduled for parole.

**Finding #4: The program may not have the resources to serve all parolees that are not mentally ill but meet other criteria for treatment services.**

The department has included in the designated population certain parolees who have problems other than mental illness—such as sex offenders and violent offenders—because it believes that they can benefit from psychiatric services provided by the program.

We found that between October 2000 and March 2001, the program failed to identify and serve more than 66 percent of sex offender parolees who were paroled during this period, even

though it was required to serve this population. However, if the program were to implement an effective identification process, it may not have the resources to serve the increased caseloads.

The department should ensure that the program has adequate processes and resources to identify and serve parolees with problems other than mental illness.

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

The department reports that it continues to assess its need for additional funding to serve its non-mentally ill population. The department stated that it recently received additional state and federal funds to provide services to these parolees.

**Finding #5: The program should take additional actions to manage expected caseload increases.**

The program's current data management system is not able to identify the level of effort—and related expense—that it incurs in treating the various types of parolees in its program. For example, a clinician may treat several different types of parolees: the mentally ill, serious sex offenders, and violent criminals. Because the program has not tracked the time clinicians spend providing services, it is not able to track how much of its resources it uses on the various types of parolees receiving treatment. Although its current system cannot collect this information, the program has an opportunity to use its new data management system to begin collecting the data it needs to determine the costs of services it provides to the different types of parolees. To accomplish this, the program would have to establish a unique designator for each type of parolee it serves, record the amount of time that clinicians spend with different types of parolees, and include all of its parolees on the system.

Moreover, the program has not developed caseload standards so that it can adequately monitor and assess the caseloads of its clinicians. The program could use standards to better evaluate its efforts, and to assess and justify the need for changes to its staffing as its workload changes.

To better identify its costs of treating parolees and to better justify additional resources it may require, the program should track the amount of time and resources it spends treating the different types of parolees.



To appropriately assess its clinicians' workloads and evaluate the need for additional resources, the program should develop caseload standards for its clinicians.

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

The department states that its new data management system tracks the number and duration of treatments provided to mentally ill parolees. Additionally, the department advised us that in September 2002, it completed the addition of parolees with problems other than mental illness onto its data management system. Accordingly, it now can track similar information for parolees it serves with problems other than mental illness. The department stated that it is still exploring opportunities to establish caseloads standards for its clinic staff.

# STATE OF CALIFORNIA

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## ***Its Containment of Drug Costs and Management of Medications for Adult Inmates Continue to Require Significant Improvements***

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

*Our review of the State's drug and medical supply procurement practices reveals:*

- ☑ *Annual expenditures for the five agencies most frequently purchasing drugs increased by an average of 34 percent per year between fiscal years 1996–97 and 2000–01.*
  - ☑ *The Department of General Services has explored a variety of options, but it has not gone far enough in improving the State's drug procurement process. Moreover, the State needs a statewide process for contracting for medical supplies.*
  - ☑ *The Department of Corrections' (Corrections) Health Care Services Division continues to have significant weaknesses that prevent it from effectively monitoring its pharmacies' purchases of drugs, such as:*
    - *As of November 2001 it had not updated its formulary nor monitored compliance with the existing one.*
    - *It lacks a utilization management program that can assist in reducing costs.*
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### **REPORT NUMBER 2001-012, JANUARY 2002**

**Department of General Services' response as of January 2003 and Department of Corrections' response as of December 2002**

Chapter 127, Statutes of 2000, required the Bureau of State Audits (bureau) to report to the Legislature on the trends in state costs for the procurement of drugs and medical supplies for offenders in state custody and to assess the major factors affecting those trends. The statutes also required the bureau to summarize the steps that the Department of Corrections (Corrections), the Department of General Services (General Services), and other appropriate state agencies have taken to improve drug and medical supply procurement and to comply with prior bureau recommendations relating to necessary reforms to improve the procurement of drugs.

In fiscal year 1996–97 state agencies purchased \$41.6 million in drugs, but in fiscal year 2000–01 their purchases rose to \$135.1 million, which represents an annual average increase of 34.3 percent for this five-year period. During the same period state agencies' expenditures for medical supplies rose from \$11.1 million to \$14.2 million, which represents roughly a 27 percent increase.

Restrictions in state and federal law prevent human immunodeficiency virus-positive inmates in federal and state prisons, such as Corrections', from benefiting from the State's AIDS Drug Assistance Program. Further, Corrections may not use the federal supply schedule, which by federal law places limits on the prices of drugs that the federal Department of Veterans Affairs, the Department of Defense, the Public Health Service, and the Coast Guard purchase because it is not affiliated with one of these eligible federal agencies.

However, we found that General Services and other state agencies such as Corrections could do more to control the State's drug and medical supply expenditures. Specifically, we found:

- Its pharmacy staff do not regularly review monthly reports to understand if purchases are cost-effective.
- Its pharmacy prescription tracking system cannot support monitoring, cost-containment efforts, or day-to-day management of pharmacy services.
- Corrections does not plan to replace this system until November 2006, and development of the new system is already behind schedule.
- Finally, we found that Corrections is not eligible for some options, such as the AIDS Drug Assistance Program and the federal supply schedule.

**Finding #1: General Services needs to do more to identify the best option for reducing drug costs.**

General Services has not been successful in securing more individual contracts with drug manufacturers for more drugs at less-than-wholesale acquisition cost, the standard price a wholesaler pays a manufacturer for drug products not including special deals, such as rebates or discounts. Further, General Services recently contracted with the Massachusetts Alliance for State Pharmaceutical Buying but failed to fully analyze other options, such as contracting with Minnesota Multistate Contracting Alliance for Pharmacy (MMCAP) or directly with a group-purchasing organization, before doing so. This action may have prevented the State from achieving greater future savings.

General Services should increase efforts to solicit bids from drug manufacturers so that it can obtain more drug prices on contract. Further, General Services should fully analyze measures to improve its procurement process, such as joining MMCAP or contracting directly with a group-purchasing organization.

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

General Services reported that it has awarded two-year contracts covering 321 line items, primarily generic drugs, which went into effect on November 1, 2002. Further, based on analysis of the bids it received, General Services identified an additional 140 drug line items for inclusion in its contract with the Massachusetts Alliance for State Pharmaceutical Buying (Massachusetts Alliance). In January 2003 General Services received statutory authority to enter into contracts

in a bid or negotiated basis with manufacturers and suppliers of single-source or multi-source drugs, which it believes allows it to explore additional strategies for managing drug costs.

General Services also reported that it was conducting a detailed review of the effectiveness of using the Massachusetts Alliance. General Services stated that as part of its review it surveyed a number of group-purchasing organizations and compared the advantages of using other group-purchasing organizations with its current relationship with the Massachusetts Alliance. General Services told us that its current agreement produced the greatest savings, which it estimated at roughly \$5.9 million annually. General Services stated that it is committed to continually evaluating other approaches and is working with MMCAP to analyze drug procurement data.

**Finding #2: Although General Services is spearheading efforts to develop a statewide drug formulary, it has not ensured that state agencies will be able to enforce the formulary.**

A drug formulary is a listing of drugs and other information representing the clinical judgment of physicians, pharmacists, and other experts in the diagnosis and treatment of specific conditions. One of the main purposes of a formulary is to create competition among manufacturers of similar drugs when the clinical uses are roughly equal. The success of a statewide formulary and the State's ability to create enough competition to negotiate lower drug prices for certain products depend on how well state agencies adhere to the statewide formulary when they prescribe drugs. Currently, Corrections, which was responsible for roughly 68 percent of the State's drug purchases in fiscal year 2000–01, has an outdated formulary and lacks sufficient data to perform reviews that can identify prescribing patterns. Agencies that help develop but do not adhere to strict guidelines for enforcing the formulary would negate the State's effort.

Therefore, General Services should fully consider, and attempt to mitigate, all obstacles that could prevent the successful development of a statewide formulary.

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

General Services has formed a Pharmacy Advisory Board (board) to assist in its implementation and administration of a statewide pharmaceutical and medical supply program. The board held one meeting in September 2002 and plans to hold its next meeting in early 2003. General Services' Common Drug Formulary Committee, which is a subcommittee of the board, has received approval to begin contract negotiations for a number of proprietary drugs that were recommended for inclusion on the State's common drug formulary listing.

**Finding #3: The State lacks statewide agreements for purchasing medical supplies.**

Often state agencies are not aware of what their institutions are purchasing and how much they are paying for medical supplies. Typically, each state agency or individual institution generally procures its own medical supplies. Currently, General Services has only two medical supply contracts and is unaware of what medical supplies the agencies use and what they pay for them. However, it believes that having a medical supply catalog would aid state agencies in obtaining these supplies.

General Services should ask state agencies to determine their needs and then consider contracting for a medical supply catalog to maximize the State's buying power.

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

General Services has formed a Medical and Surgical Supply subcommittee to focus on the needs of state and local government entities. General Services reported that it is developing a request for proposal for the medical and surgical supply program, which it expects to release in early 2003.

**Finding #4: Corrections' Health Care Services Division (Health Care Services) lacks an effective system for controlling drug purchases.**

Despite the recommendation in our January 2000 report to update its departmental formulary and use it to control which drugs medical professionals can prescribe routinely, as of November 2001, Corrections' Health Care Services still had not done so. Further, Health Care Services does not monitor its pharmacies' noncontract purchases from the

State's prime vendor and cannot substantiate the reasons they are choosing to purchase potentially more expensive noncontract drugs. Until Health Care Services addresses significant deficiencies, neither an external or internal pharmacy benefits manager can accomplish the task of improving its contracting and procurement for drugs.

As we previously recommended, Health Care Services should update its formulary and ensure that headquarters and prison staff monitor compliance with the formulary. Further, Corrections should ensure that prisons receive monthly contract compliance reports from the prime vendor and use them to monitor noncontract purchases. Finally, Corrections should await the results of its consultant's report and identify those recommendations that will be beneficial to the program. Only then should it decide whether to hire an internal or external pharmacy manager to assist in resolving its pharmacy operations deficiencies.

***Corrections' Action: Partial corrective action taken.***

Corrections reported that it had revised its formulary and planned to distribute it in early 2003. It also plans to hold trainings on this formulary and on the use of reports it receives from the prime vendor to monitor noncontract purchases. Corrections also reported that it received its consultant's report and identified the recommendations beneficial to the pharmacy program, such as the creation of a Pharmacy Services Unit at its headquarters. However, although it has identified the resources necessary to implement the recommendations, Corrections reported that it is still in the process of filling the position of pharmacy services manager for that unit.

**Finding #5: Health Care Services did not always meet criteria for using mail-order pharmacy services.**

Although Corrections obtained approval from General Services to use mail-order pharmacy services in prisons when pharmacist vacancy rates rise to more than 50 percent, it did not demonstrate that the use of mail-order pharmacy services was necessary. Specifically, we cannot substantiate Corrections' shortage of pharmacists and thus its need for mail-order pharmacy services because Health Care Services lacks sufficient information about its use of registry employees. A registry service provides

pharmacists who can fill in for long- or short-term staffing needs resulting from vacancies, illnesses, or exceptional workload conditions.

Further, Corrections still has not addressed our previous recommendation that it consider whether it has appropriately divided responsibilities between its pharmacists and pharmacy technicians. This analysis could indicate that Corrections may be able to allow pharmacy technicians to assume more responsibilities so that it can lower the number of pharmacists necessary to run its pharmacies.

Corrections should take the necessary steps to substantiate its position that a shortage of pharmacists exists. Additionally, it should analyze whether it has the appropriate division of responsibilities between its pharmacists and pharmacy technicians. If it is able to substantiate that a pharmacy shortage exists and General Services approves another contract for mail-order pharmacy services, Health Care Services should ensure that prisons meet the contract conditions before beginning to use these services and monthly thereafter.

***Corrections' Action: Partial corrective action taken.***

Corrections reported that it has gathered and reviewed data related to pharmacists, pharmacy technicians, the number of satellite pharmacies, and its use of registry pharmacists to evaluate the extent of a pharmacist shortage. However, Corrections told us that it is unable to determine the appropriateness of the staffing ratios until it decides on which consultant recommendations it will implement.

**Finding #6: Although its prescription tracking system is inadequate, Corrections has made little progress in implementing a new system.**

Corrections has been trying to replace its prescription tracking system and other health care information technology systems since 1991 without significant progress. Currently, it is behind schedule on its plans to implement a new health care management system by November 2006 as part of its Strategic Offender Management System and is not considering an automated pharmacy system in the interim.

Corrections should accelerate the acquisition and implementation of the Strategic Offender Management System and its new health care management component.

***Corrections' Action: Partial corrective action taken.***

Corrections reported that its implementation of the new system depends on infrastructure and resources. However, Corrections also reported that it has completed a feasibility study report, as an interim solution, to procure an existing pharmacy management software package for its local institutions and headquarters. Corrections told us that the report is being reviewed by the Department of Finance.

**Finding #7: Corrections made significant errors in attempting to streamline its drug dispensing process.**

Corrections neither sought the necessary approvals to contract with the vendor of an automated drug delivery system nor ensured that it uses the system in accordance with state law. The California State Prison, Sacramento's, entering a limited-time agreement to obtain two machines for \$4,999.99 appears to be a circumvention of the State's requirement of securing at least three competitive bids for each contract of \$5,000 or more.

Corrections also failed to consider thoroughly the legal ramifications of using an automated drug delivery system. To control misuse, state law allows the removal of drugs from these machines in only one of three circumstances: (1) to provide drugs for a new prescription order, (2) to provide drugs in an emergency, or (3) to provide drugs that the medical practitioner has prescribed for an inmate to take as the need arises. Corrections contends that it is using the system appropriately, since the law pertains only to skilled nursing or intermediate care facilities. However, our attorney's analysis of the law is that Corrections' authority to use these machines in health care facilities in its prisons is unclear. Specifically, although the legislative history of Senate Bill 1606 indicates that the Legislature had skilled nursing and intermediate care facilities in mind when drafting it, the state law setting forth the circumstances in which automated drug delivery machines may be used refers to "facilities" in a generic sense and not merely skilled nursing and intermediate care facilities.



Corrections should cease using its automated drug delivery system until it secures a contract in accordance with the State's public contracting laws. Further, Corrections should seek an opinion from the attorney general to support its current use of the machines.

***Corrections' Action: Partial corrective action taken.***

Corrections reported that it received approval on a contract for the automated drug delivery machines on December 24, 2001. However, Corrections has chosen not to seek an opinion from the attorney general because it does not believe that Health and Safety Code, sections 1261.5 and 1261.6, apply to its pharmacies.

# DEPARTMENT OF HEALTH SERVICES

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## ***It Needs to Significantly Improve Its Management of the Medi-Cal Provider Enrollment Process***

REPORT NUMBER 2001-129, MAY 2002

Department of Health Services' response as of November 2002

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

*Our review of the Department of Health Services' Provider Enrollment Branch's management of the Medi-Cal provider enrollment process revealed that:*

- ☒ *It lacks reliable data to determine the size of its backlog.*
  - ☒ *It could not substantiate its decisions to designate certain providers as being at high risk for fraud.*
  - ☒ *It did not always review disclosure statements required by the federal Health and Human Services Agency, aimed at identifying applicants with a history of defrauding or abusing the Medicaid system.*
  - ☒ *It will continue to have difficulty effectively managing its operations until it develops a strategic plan and fully implements its data tracking system.*
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The state Department of Health Services (department) administers California's Medicaid program, referred to as Medi-Cal, which accounts for almost \$27 billion in annual expenditures. A provider must obtain a valid Medi-Cal provider number in order to bill the Medi-Cal program for services provided to an eligible Medi-Cal beneficiary. The department's Provider Enrollment Branch (branch) is responsible for reviewing applications for providers such as physicians, physician groups, pharmacies, and clinical laboratories. The branch received more than 27,000 applications between February 14, 2001, and January 31, 2002.

The Joint Legislative Audit Committee requested that we examine the process used by the department for enrolling Medi-Cal providers. Our audit concluded that until the branch addresses certain deficiencies, it would continue to have difficulty meeting its regulatory timelines, securing additional staff, and effectively managing its operations. Specifically:

### **Finding #1: The branch cannot determine the number of applications remaining to be processed.**

The branch does not know how many of the roughly 27,000 applications it received between February 14, 2001, and January 31, 2002, have been approved, denied, or remain to be processed. In February 2001, the branch instituted a new database—the Provider Enrollment Tracking System (PETS)—which can provide such information. However, branch management is unable to use PETS to provide management reports that will allow it to determine the number of applications awaiting final disposition because staff have not always entered data into the database consistently. Although

the branch had devoted time and resources to develop PETS and train staff, we found no evidence that the branch has implemented a procedure to review periodically the data that staff input into PETS. Because staff do not enter data into PETS consistently, the branch can neither effectively track the applications it processes nor use the reports PETS is capable of producing to identify its backlog and manage its operations.

We recommended that to improve the management of the Medi-Cal provider enrollment process, the branch should use PETS more effectively to track how long an application has been in a certain step of the enrollment process, making sure that notification is sent to the applicant at proper intervals; and modify PETS so it can track the status of high- or low-risk provider types and determine whether the average processing times vary. The branch also should identify all applications that, according to PETS, are still in progress, determine their actual status, and update PETS, if necessary. Further, the branch should review PETS-generated reports at least monthly and perform analyses to determine whether staff are entering data accurately and consistently. Finally, it should fully use the capabilities of PETS for developing reports on a variety of productivity indicators, including, for example, aging reports and reports showing the number of applications approved, denied, and in progress.

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

In its six-month response dated November 20, 2002, the department stated that some procedures have been implemented to use PETS to determine the length of time an application is in process, track the status of high- and low-risk provider types, and determine the average processing time for both. Additionally, in order to conform to the time frames required by the enrollment regulations, PETS now generates several reports for department staff to use to track the progress and status of pending applications. Further, PETS has been modified to allow staff to track those applications that are resubmitted and to automate requests for onsite visits. The department expects to complete its modifications to PETS and implement them by the end of fiscal year 2002–03.

At the end of December 2002, the department completed the establishment of additional edits in the PETS database to ensure data is valid. The branch will continue to monitor and review reports produced by PETS and add edits to meet program report needs if required.

**Finding #2: The branch does not ensure that it reviews applications within 180 days.**

Although PETS cannot provide meaningful information for those applications that are pending branch action, it does show that the branch frequently took more than 180 days to process some applications. We found that the data was reliable when branch staff entered both the receipt and completion date. In addition to not consistently tracking the applications it processes internally, the branch also does not monitor applications it refers to the department's Audits and Investigations (A&I) unit for on-site reviews. The branch does not use PETS to establish or track dates indicating when it should receive a response back from A&I so that it can meet its regulatory deadlines.

We recommended that to improve its monitoring of referrals, the branch should use PETS to track applications it refers to A&I. Also, the branch should work closely with A&I to monitor the status of its referrals to ensure that the total review time for applications does not exceed regulatory requirements. In addition, the department should establish policies and procedures for the branch and A&I to coordinate their review processes so it is able to meet regulatory requirements and ensure that A&I implements its new case-tracking system by late 2002.

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

The department reported that by the end of fiscal year 2002–03, in addition to having the data in PETS, the branch will enter all of its referrals directly into A&I's new case-tracking system. Some branch staff have received training in the use of the new system, which will enable both A&I and the branch to determine the status of any referrals. In addition, procedures for A&I and branch staff to coordinate their review processes will be finalized with full implementation of A&I's new case-tracking system by the end of fiscal year 2002–03.

**Finding #3: The branch could not substantiate its decisions to designate certain providers as high- or low-risk.**

The branch's objective is to prevent providers with fraudulent intent from participating in the Medi-Cal program. Consequently, it is reasonable that the branch should use relevant and available information to identify those provider types that pose a greater risk of fraud. Further, the branch should document these

decisions and review them periodically to ensure that they are still relevant. However, the branch could not substantiate how it determines the risk that it assigns to certain provider types, nor does it reevaluate its risk assessment periodically.

We recommended that the branch periodically perform an analysis to justify its existing risk assessments for high- and low-risk provider types and submit its analysis for department approval. Upon approval of the analysis, the branch should issue a policy memo to staff. Further, the department should formalize its process for determining which provider types should be subject to increased scrutiny and when, based upon the most recent anti-fraud trend information available.

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

The department stated that informally it continually evaluates risk assessments for effectiveness and applicability. The department told us that it will continue to work with its partners to identify and evaluate risk indicators and trends. If any significant changes in current assessments of high- and low-risk providers are proposed, formal documentation will occur. Also, A&I and the branch have established monthly meetings with the first meeting occurring in January 2003, to address anti-fraud issues and to review all provider types that need closer scrutiny. The meetings will include the division chiefs from both programs.

**Finding #4: The branch needs to rectify its poor decision to cease reviewing certain provider disclosure statements, which exposes the State to loss of federal funds.**

Although both state and federal regulations require applicants or providers to submit disclosure statements with their applications, in its effort to reduce its backlog, the branch inappropriately stopped reviewing disclosure statements for certain applicants or providers. Specifically, the branch did not review all disclosure statements received between October 2000 and September 2001 for physician and allied group applicants or providers. As a result, the branch increased the risk of enrolling providers who may have disclosed questionable financial relationships or a past history of fraud, abuse, or criminal convictions relating to other Medicare or Medicaid programs.

We recommended that the branch identify all physician providers who were enrolled between October 2000 and September 2001 and review their disclosure statements in accordance with federal requirements. The branch should direct staff to continue to review disclosure statements for all providers.

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

The department reported that it plans to implement this recommendation on a flow basis. Specifically, as the branch receives requests or inquiries from providers who enrolled between October 2000 and September 2001, staff will review the initial application. If the initial application does not include a disclosure statement, one will be requested and reviewed.

**Finding #5: Reenrollment of existing providers could strengthen the Medi-Cal enrollment process.**

To strengthen the enrollment process and weed out potentially fraudulent providers, the branch should expand its efforts to reenroll existing providers. In August 1999, the department began to reenroll certain provider types identified as problematic. The branch is continuing its efforts to reenroll durable medical equipment and non-emergency medical transportation providers. However, due to the increase in workload resulting from its reenrollment efforts, the branch has postponed its reenrollment of independent pharmacies until summer 2002.

We recommended that the branch complete its current reenrollment efforts and consider expanding these efforts to include all provider types to ensure provider integrity in the Medi-Cal program.

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

The department told us that its reenrollment efforts of durable medical equipment, orthotics and prosthetics, and non-emergency medical transportation providers are substantially complete. Further, with the passage of the state budget for fiscal year 2002–03 in October 2002 and the approval of 20 new positions, the branch moved forward in October 2002 with a reorganization package to establish a reenrollment section to fully expand the anti-fraud activities and expand the branch to incorporate reenrolling all provider types on a rotating basis with a focus on pharmacy and physician providers.

With the delay in the passage of the state budget and the hiring freeze, the reenrollment section became fully staffed on December 31, 2002.

**Finding #6: A strategic plan would help the branch address its performance deficiencies.**

The branch has addressed only a few of the essential elements of strategic planning such as defining its mission and establishing its top priorities. However, the branch has not described the actions necessary to achieve its top priorities. For example, the branch states that it will reduce the backlog of physician applications, but does not address critical questions relevant to doing so, such as how it will determine the number of applications in progress and whether it has sufficient staff.

We recommended that the branch should develop a strategic plan to identify key responsibilities and establish priorities. This plan should clearly describe how the organization would address its many short- and long-term responsibilities, particularly those that we observed it has not sufficiently accomplished. In addition, the branch should conduct a study to determine how long it takes staff, on average, to process applications for the various provider types. Using results from the study and accurate workload standards, the branch should assess whether it has the appropriate staffing levels.

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

The department reported that it developed a draft strategic plan for management review and approval. In addition, the branch's analysis of how long it takes staff to process applications for the various provider types should be complete in the spring of 2003. The department believes the strategic plan will be completed by June 2003.

**Finding #7: The department did not adhere to state hiring practices in its efforts to seek additional resources for the branch.**

Although state laws establish the standards to use in contracting for personal services, the department did not follow these standards when attempting to secure employees to assist the branch with processing provider enrollment applications. Specifically, the department had not obtained approval to use up to 10 contractor staff to assist the branch during the period

of July 2001 through January 2002, but had incurred costs of roughly \$490,000. Also, the department may not have met the State's standards for using personal services contracts when it hired student assistants through contracts with the California State University Sacramento Foundation (foundation). Between March 1, 2001, and January 31, 2002, the branch incurred costs of more than \$138,000 in salaries, employment taxes, and fees to reimburse the foundation for the 22 student assistants it hired. However, the department did not prepare an analysis to demonstrate that contracting with the foundation could result in actual overall cost savings to the State.

We recommended that the department should discontinue its use of contractor staff to assist the branch in processing provider enrollment applications. It should also ensure that it adheres to state standards for using personal services contracts when hiring employees such as student assistants.

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

The department stated it discontinued its use of contractor staff by May 31, 2002, and that it adheres to state standards for using personal service contracts when hiring employees such as student assistants.





# DEPARTMENT OF MANAGED HEALTH CARE

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## ***Assessments for Specialized and Full-Service HMOs Do Not Reflect Its Workload and Have Disparate Financial Impacts***

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

*Our review of the assessment structure of the Department of Managed Health Care found that:*

- ☑ *The portion of assessments charged to specialized health maintenance organizations (HMOs), at 48 percent, exceeds the 22 percent of identifiable workload attributable to specialized HMOs.*
- ☑ *The current assessment structure results in disparate financial impacts with specialized HMOs charged about nine times more per dollar of premiums than full-service HMOs.*
- ☑ *Alternative methods could better align assessments with workload and reduce disparities in financial impact.*

*In addition, our review of six core operating units found that:*

- ☑ *Four units are meeting deadlines and/or have greatly expanded services.*
  - ☑ *Two units, Financial Oversight and Licensing, are often late issuing financial examination reports and sending written notifications to HMOs regarding material changes in health care plans.*
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**REPORT NUMBER 2001-126, MAY 2002**

**Department of Managed Health Care's response as of November 2002**

The Joint Legislative Audit Committee requested that we review the assessment mechanism used to generate funds for the Department of Managed Health Care (department) to determine whether the assessments paid by different classes of health maintenance organizations (HMOs) reflect the level of regulatory activity related to them. It also asked us to propose alternative assessment structures, if necessary, that would more closely reflect the level of regulatory costs and ensure adequate funding to meet the department's statutory responsibilities.

### **Finding #1: The annual assessments paid by two classes of HMOs—specialized and full-service—are not distributed equitably.**

The percentage of the total assessment that the department charges to specialized and full-service HMOs does not match the level of effort the department devotes to these two classes of HMOs. Although assessments for specialized HMOs amount to 48 percent of total assessments, only 22 percent of the department's work that is identifiable by HMO class is attributable to them.

In addition, the financial impact of the assessment on HMOs, as represented by the percentage of their premiums that the HMOs are charged for assessments, varied widely between the different classes of HMOs. Specifically, the assessments the department billed to full-service HMOs amounted to about 0.04 percent of their premiums on average, while those for specialized HMOs amounted to about 0.37 percent on average, or about nine times more per premium dollar.

We developed four alternative assessment methodologies and found that two would both better reflect actual workload and reduce the disparity in financial impacts. Assessments under these two methods are based in whole or in part on the split in identifiable workload between specialized and full-service HMOs, and on total premiums received by individual HMOs.

We recommended that the Legislature consider changing the department's assessment structure to reflect the proportion of the documented workload that the department devotes to specialized and full-service HMOs and to reduce disparities in the financial effect on HMOs. We also recommended that the Legislature require the department to report to it triennially on the proportion of assessments charged to each class of HMO and the proportion of the documented workload related to each class of HMO.

***Legislative Action: Legislation passed and then nullified.***

In September 2002, the Governor approved legislation requiring full-service HMOs to pay for a larger share of the department's costs. This change in the law was, however, nullified by subsequent legislation, also approved in September 2002, which changed other provisions of the law, but left the original assessment structure intact. Further, current law has no provision requiring the department to report triennially to the Legislature.

**Finding #2: The department is generally effective in meeting deadlines, but it must improve the timeliness of financial examinations and its responses to requested plan changes.**

The department has increased the output for some of its core functions, has introduced several new services for HMO enrollees, and is generally better at meeting deadlines when compared to the same functions previously carried out by the Department of Corporations (Corporations). For example, in the first half of fiscal year 2001–02, the department's Division of Plan Surveys completed 20 routine medical surveys (surveys) and ended calendar year 2001 with only 4 backlogged surveys. In contrast, Corporations had an output of 7 surveys in the first half of fiscal year 1998–99 and 40 backlogged surveys at the end of calendar year 1998.

On the other hand, the department's Division of Financial Oversight is having difficulty completing financial examinations on time. Its backlog of 13 examinations at the end of calendar year 2001

compares unfavorably to the backlog of 2 examinations that Corporations experienced at the end of calendar year 1998. The Division of Financial Oversight has seen a large increase in its routine workload which, combined with staff vacancies and an increase in nonroutine work, contributed to the backlog. When the department does not complete financial examinations on time, the public is not fully informed of the financial status of HMOs.

In addition, the department's Division of Licensing has often failed to promptly notify HMOs of its decision regarding the HMO's requests to make significant changes, known as material modifications, to health plans. It was late in sending written notifications for 42 of the 122 material modification filings it received in 2001. According to department staff, workload issues may have been a factor contributing to late notifications. In addition, the Division of Licensing had no reliable means of tracking the status of its workload, and limitations in its manual processes made it difficult to ensure that statutory turnaround requirements were met. When the department does not notify HMOs of delays in approving their requests for changes, they are not able to respond to department concerns, resulting in delays in changes that the HMOs believe are necessary and significant.

We recommended that the department establish deadlines for the publishing of financial examination reports and closely monitor the success of its efforts to meet deadlines for these reports. In addition, we recommended that the department closely monitor the time elapsed between its receipt of requests for material modifications and the notifications it sends to HMOs, and make it a priority to send written notifications within the statutory deadline.

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

The department says it now includes target preliminary report and final report dates on its examination schedule and is making all reasonable efforts to remain compliant with statutory deadlines. The department believes no examination reports are currently out of compliance with statutory deadlines. The department says that it has also taken steps to ensure that health plans are promptly notified of the status of their material modifications. Department attorneys are required to issue within a 20-business-day period either (1) an order of approval, denial, or postponement; or (2) a deficiency letter, upon request from an HMO to extend the statutory period.



# DEPARTMENT OF REHABILITATION

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## ***Its Delay in Correcting Known Weaknesses Has Limited the Success of the Business Enterprise Program for the Blind***

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

*Our review of the Department of Rehabilitation's (department) administration of the Business Enterprise Program for the Blind (program) reveals that:*

- ☒ *Program participants' (operators) average net income has increased, but 30 percent of them still earned less than the minimum wage in fiscal year 2000–01.*
- ☒ *In May 2002 the department completed its first strategic plan for the program; however, the plan lacks defined outcomes and performance measures.*
- ☒ *Although the department has been working for more than seven years to update its regulations, it has yet to do so.*
- ☒ *The department has not ensured that partnerships between operators and private food-service businesses are consistent with federal law and pay their fair share of program costs.*

*continued on next page*

**REPORT NUMBER 2002-031, SEPTEMBER 2002**

**Department of Rehabilitation's response as of November 2002**

The California Welfare and Institutions Code, Section 19640.5, requires the Bureau of State Audits to conduct a fiscal audit of the Business Enterprise Program for the Blind (program) every third fiscal year until January 2002 and a programmatic review every five years until January 2003. This programmatic review is the last of the series of reviews required by the statute. The program trains qualified blind persons to operate their own food-service businesses and provides them with food service facilities located in government buildings throughout the State. Specifically, we found:

### **Finding #1: The department only recently provided strategic direction to its staff and participants.**

In May 2002, in conjunction with the California Vendor's Policy Committee, the Department of Rehabilitation (department) issued its first strategic plan for the program. The department's previous lack of action to establish strategic priorities for the program, identify expected outcomes, or offer methods to measure improvement hampered the program's ability to fulfill its mission and to address deficiencies in its operations that various audits identified as early as 1991. The plan does not reflect decisions regarding the prioritization of scarce resources, show which areas the department believes the program needs to improve the most, or provide any mechanism for the program to use to determine what level of resources to expend to attain planned objectives. Moreover, the current plan does not identify expected outcomes or offer performance measures or benchmarks. Consequently, the department might dedicate resources to an area but never be able to determine if the program has reached—or is moving toward—a stated goal.

- ☑ *Since August 1998 the program has not actively pursued the collection of past-due vending machine commissions from private companies.*
  - ☑ *The program does not adequately monitor operators or provide them with all required consulting services.*
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We recommended that the department, in consultation with the California Vendor's Policy Committee, should revise the program's strategic plan to include expected outcomes and performance measures so the department can evaluate the program's success and measure its progress in achieving strategic goals and improving noted deficiencies.

***Department Action: None.***

The department reported that it will revise its strategic plan to incorporate expected outcomes and performance measures.

**Finding #2: The department has not updated its guidelines for administration of the program.**

The department lacks guidance the program needs for sound administration. The program has neither updated its regulations nor provided updated policies for program administration to its staff. The lack of clear guidance may lead to disparate service delivery and compromise the program's success. State law and regulations require that every three years the department review and consider updating its regulations for the administration of the program. However, the department has been working for at least seven years to update the regulations. Because of this delay and the program's reliance on a 1994 policy and procedures manual that is outdated in some areas and provides insufficient guidance in others, the program has lacked clear guidelines on how it should operate. The program has not provided sufficient guidelines in its purchase of equipment and establishment of private partnerships. As a result, the department cannot ensure that the purchase of equipment is consistent among locations and that its private partnerships conform to federal law and its own mission statement. The department attributes its delay in updating its regulations on staff vacancies and on the magnitude and importance of the task; however, we found the department's reasons for not being able to establish guidelines to be unfounded. The department is currently developing a new draft of the proposed regulations, but it has not established timetables or deadlines to manage the process. The department intends to revise its policy and procedures manual to coincide with the new regulations once they are adopted.

We recommended that the department should aggressively and promptly pursue development of program regulations. If the current draft is too complex or lengthy, the program should consider breaking the draft regulations into segments, first

identifying and addressing the highest priorities. The department should ensure that the guidelines include measures that will improve consistency in equipment purchase decisions, including a list of allowed and disallowed equipment and supplies, and statewide criteria for equipment purchase and replacement.

***Department Action: Pending.***

The department reported that, in consultation with the California Vendors' Policy Committee, the department will aggressively pursue updates and revisions to the regulations consistent with the department's needs, priorities, and resources. The department reported that it is currently developing a timetable to take these actions.

The department disagrees with our finding that it lacks sufficient guidelines to ensure that staff members use the same standards or information to decide whether equipment purchases are warranted. The department reported that it believes its current system provides consistency and flexibility. However, it will re-evaluate applicable regulations and guidelines to determine whether revisions are needed.

**Finding #3: By allowing operator partnerships with private businesses, the program has collected inequitable operator fees and may not have complied with federal law.**

By encouraging private partnership agreements between blind operators and private food service businesses, the department recently has allowed the private businesses to obtain program benefits that federal law intended for blind operators. Under a private partnership agreement, a contract between a program participant and a private food service business, the private business pays the program participant a monthly amount and in exchange is allowed to prepare and sell food at a program site in a state or federal building and to receive other program benefits such as consulting services and equipment maintenance.

We found numerous problems with the program's administration of its private partnership agreements. Specifically, it has not adequately ensured that its actions conform to the intent of the federal Randolph-Sheppard Act under which the program was created. Moreover, because it has not developed guidelines on when or how to implement the partnerships, it cannot be sure that the partnerships are allowable, prudent, or consistent or that they protect the interests of the State or the program



participants. Because of the terms of the partnerships, the department has lost its ability to monitor the investment of program funds in these locations in the same way that it can monitor the use of program funds at other locations, and it has not obtained enough information from the partnerships to determine if they are successful business ventures. Further, although the program generally provides the same services to private partnerships that it would to other program participants, it allows some partnerships to pay disproportionately lower fees than other program participants pay.

To improve its administration of private partnerships, we recommended that the department take the following steps:

- Establish and follow guidelines for partnerships, ensuring that they are in agreement with federal and state law, regulations, and guidance.
- Require program staff to further study the cost and benefit of each partnership to ensure that future agreements do not inequitably drain program resources.
- Establish a review process for proposed private partnerships that allow the department to adequately protect the interests of the State and program participants.
- Monitor partnerships to enable the department to compare the costs and benefits of partnerships and determine if they achieve program objectives.
- Ensure that program staff are able to monitor the success of all locations, including private partnerships.

***Department Action: None.***

The department reported that, in consultation with the California Vendors' Policy Committee, it will establish guidelines, including regulations as appropriate, for agreements between program participants and private entities to ensure compliance with federal and state law, regulations, and guidance.

The department stated that it already evaluates the costs and benefits of agreements between program participants and private entities, but will review its evaluation process to ensure that the review adequately protects program resources.

The department reported that it does not plan to establish a review process for proposed partnerships. It believes its current process adequately protects the interests of the State and program participants.

The department also reported that it would review its monitoring procedures to further its ability to compare the costs and benefits of agreements and determine if they achieve program objectives.

Further, the department reported that it will continue to monitor the success of all locations.

**Finding #4: The department has not corrected flaws in its process for pursuing past-due commissions, some of which may now be uncollectible.**

Since August 1998 the department has not actively collected past-due commissions owed to the program by private vending machine businesses operating on federal and state properties. The department's lack of pursuit of these past-due commissions may have rendered these commissions uncollectible. Moreover, the department's collection process is inadequate and its new database cannot track past-due commissions. This problem has been compounded because the department has not maintained all its contracts, conducted planned audits, and appropriately trained its collection staff.

We recommended that the department consider moving the commission-collection function to its accounting section, which already collects operator fees for the program and possesses the necessary collection knowledge and accounts receivable tracking system.

***Department Action: Pending.***

The department reported that it will evaluate the feasibility and resources available to move the commission-collection function to the department's accounting section or other appropriate section within the department. Further, it reported that it continues to refine its database.

**Finding #5: The department has not consistently met all of its responsibilities to program participants as required by law and its own regulations.**

By not fulfilling all its responsibilities to program participants in terms of training, feedback, and financial monitoring, the department may have hindered the ability of participants to succeed and engage in improved work opportunities. Specifically, the department has not complied with state law that requires it to provide the program's initial training in two locations, nor has it consistently provided upward mobility training as required by federal law. Further, the department has not always offered operators documented feedback that might enable them to increase the success of their facilities even though its own policies require that it give such feedback every three months. Finally, the department has not ensured that operators submit required financial reports and fees, and thus cannot readily identify operators who may be having operating difficulties and need assistance.

We recommended that the department offer program participants a second training location and ensure that it identifies and offers upward mobility training classes. Further, the department should track location reviews to ensure that business enterprise consultants complete the reviews at least quarterly. We also recommended that the department should ensure that consultants contact operators regarding missing monthly operating reports when they are a month or more delinquent as required by regulations, and discontinue its practice of waiting 60 days before identifying delinquent monthly operating reports. Finally, the department should ensure that the program monitors operators adequately to prevent the accumulation of significant past due fees and lengthy delinquencies in reporting. When operators refuse to submit financial reports as required by regulations, the department should demonstrate it is willing to suspend and terminate operators' licenses to ensure compliance with program requirements.

***Department Action: Pending.***

The department reported that it is evaluating its entire training program to ensure it meets the needs of program participants. It also reported that it has reminded staff of the importance of location reviews and directed staff to perform them at least quarterly. In addition, it reported that it is revising its tracking system to ensure that required reviews are completed.

Further, the department reported that although it believes it enters operating report data timely, it will review the process to determine where it can improve. It also reported that it is developing procedures to ensure that operators are contacted regarding missing monthly operating reports when the reports are a month or more delinquent, as required. Finally, the department reported that it will continue to pursue operators with delinquent reports and unpaid fees consistent with its available resources and priorities.

**Finding #6: The department has not corrected weaknesses in its process for assigning interim locations.**

In a previous report, issued in August 1997, we reported that the department's policy for classifying and circulating announcements for available locations was inequitable because it had not developed a fair process for assigning interim locations. To date, the department still has not corrected this weakness.

To ensure that its application and selection process for locations is equitable, we recommended that the department establish procedures to circulate announcements for all permanent and interim food service locations to eligible operators.

***Department Action: None.***

The department reported that it has established procedures to circulate announcements for all permanent locations. Further, it reported that it has established appropriate and fair procedures to select interim operators but that it will re-evaluate the procedures to ensure they are equitable.



# DEPARTMENT OF HEALTH SERVICES

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## ***It Needs to Better Control the Pricing of Durable Medical Equipment and Medical Supplies and More Carefully Consider Its Plans to Reduce Expenditures on These Items***

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

*Our review of the Department of Health Services' (department) purchasing and contracting practices for durable medical equipment (DME) and medical supplies under the California Medical Assistance Program (Medi-Cal) revealed that:*

- ☒ *While the number of beneficiaries and related expenditures are increasing, federal funding for Medi-Cal is likely to decrease by \$222 million in fiscal year 2002–03.*
  - ☒ *The department's cost control procedures have not prevented significant spending increases for unlisted items—those with no established maximum allowable product costs (MAPCs).*
  - ☒ *It has been more than 15 years on average since the department last updated the MAPCs for many medical supplies.*
  - ☒ *The department's inadequate planning for two initiatives it believes will reduce its DME and medical supply costs—converting its medical supply billing codes to universal product numbers and negotiating contracts with manufacturers—may undermine their success.*
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### **REPORT NUMBER 2002-109, DECEMBER 2002**

### **Department of Health Services' response as of November 2002**

The Joint Legislative Audit Committee asked us to examine the Department of Health Services' (department) purchasing and contracting practices for durable medical equipment (DME) and medical supplies under the California Medical Assistance Program (Medi-Cal). We found that the department's cost control procedures have been ineffective in reining in spending for items with no maximum allowable prices (unlisted items). In addition, the department has failed to ensure that it does not approve expenditures for unlisted DME items that should be charged under listed codes at a lower cost. Further, the department has delayed price updates for its medical supplies for an average of 15.5 years, and many of its product codes may be obsolete. Finally, the department's inadequate planning for two initiatives it believes will reduce its DME and medical supply costs may result in increased administrative costs and a failure to reduce expenditures.

### **Finding #1: The department's cost control procedures have been ineffective in reining in spending for unlisted items.**

The department's expenditures for unlisted DME and medical supplies have increased significantly over the past four years, and its cost control procedures have done little to rein in these expenditures. Specific areas our audit identified include:

- The department's payments for unlisted DME items accounted for most of the increases in expenditures for all DME. From 1998 through 2001, expenditures for unlisted DME increased by \$34.3 million, or 89.4 percent. Similarly, the department's expenditures for unlisted medical supplies increased, even though total medical supply expenditures have decreased in recent years. In 2001, the department paid 11.1 percent less

for medical supplies with established maximum prices, but 27.5 percent more for medical supplies without such prices than it did in 1998.

- Although state regulations require providers and manufacturers to provide Medi-Cal with rates that do not exceed the price they charge to the general public, in December 1997, the department instructed its field office staff to discontinue reviewing authorization requests for cost.
- Field office staff lack cost-comparison tools, such as functional equivalence tables, that would allow them to compare requested items to other items that perform the same essential functions. Because they lack this information, the field office staff must rely on their experience and judgment to determine whether amounts are appropriate. Further, because the department lacks cost-comparison tools that will allow its field office staff to make meaningful comparisons of the requested items with other available products, field office staff tends to approve a product regardless of cost as long as it is medically necessary.
- We found that other states have some procedures that the department may wish to consider adopting. For example, we found that New York's Medicaid program caps reimbursement for unlisted items at the lesser of 150 percent of the provider's acquisition cost, or the provider's usual and customary charge to the general public. Further, New York uses a voice-activated authorization system to process routine authorization requests and thus free up staff resources to perform other reviews.
- Field office staff do not ensure that providers use listed codes whenever possible or justify why they do not. By not doing so, the department may pay more for an unlisted item than it would pay for another listed or unlisted item that meets the patient's needs. In fiscal year 2001–02, the department paid an average of \$622 for wheelchairs with listed codes, but an average of \$3,121 for unlisted wheelchairs.
- While the department attributed the large difference in average prices for listed versus unlisted wheelchairs to obsolete maximum allowable product costs (MAPCs)—the department last updated its MAPCs for listed wheelchairs in 1985 (17 years ago)—we found that the department's failure to enforce cost control procedures also contributed to the rising cost of unlisted wheelchairs. For example, the department's June 1998 policy statement requires field

office staff to approve unlisted wheelchairs only if providers document information including why a listed code cannot be used for the equipment the patient needs, and that the requested wheelchair is the lowest cost item among other comparable brands or types that meet the patient's medical needs. However, field office staff apparently approve requests for prior authorization for all wheelchairs as long as the requests are accompanied by a physician prescription. Staff also allow the use of unlisted codes for all wheelchairs and components. Consequently, the department may be paying more than necessary for customized wheelchairs.

We recommended that the department should do the following to ensure that it receives a fair and reasonable price for DME, medical supplies, and hearing aids:

- Analyze its payments for unlisted DME and medical supplies to determine whether it should establish maximum allowable product costs for any of these items.
- Analyze periodically its expenditures to determine utilization of high-dollar items and possible causes for increases in expenditures.
- Consider developing a voice-activated authorization system for straightforward transactions to free staff resources for more complex prior authorizations or cost analyses.
- Develop tools, such as functional equivalence and price comparison tools, for its field office staff to compare prices among similar items for unlisted DME and medical supplies.
- Cap reimbursement for unlisted items at the lesser of a department-determined percentage of the provider's cost (e.g. 150 percent of cost) or the provider's usual and customary cost charged to the general public, and require providers to submit their cost information with claims for reimbursement.
- If the department does not wish to set this cap and require providers to submit cost information, it should enforce its requirement that providers of unlisted wheelchairs document why the wheelchair cannot be billed under listed codes and that the recommended wheelchair is the least costly of alternative items that meet patient needs.



***Department Action: Pending.***

The department's response indicates that it agrees with our recommendations. Specifically, it plans to take the following steps:

- Proceed to resolve difficulties with establishing new product codes and MAPCs under the Health Insurance Portability and Accountability Act of 1996.
- Evaluate the possibility of expanding beyond existing efforts with its fiscal intermediary to analyze expenditures to determine root causes of increases, contingent on the availability of staff.
- Add a control to its verification system to identify when beneficiaries are exceeding the department's limit of \$165 for incontinence supplies per month by using multiple providers. However, the department does not anticipate establishing a voice-activated authorization system at this time.
- Pursue a new contracting process that it hopes will allow it to establish guaranteed provider acquisition costs for many DME items.
- Resolve current issues related to defining a "custom" versus a "non-custom" wheelchair, the appropriate procedure codes to use for these chairs, and the proper rate to pay for these chairs.

**Finding #2: The department overpaid for some rentals.**

Field office staff's misunderstanding of regulations may have caused the department to pay \$8.3 million more for renting stationary volume ventilators over three years than the department would have paid by purchasing these items. Our review found that the department would have paid \$4.1 million if it had purchased these items, rather than the \$12.4 million it paid for renting them. Field office staff stated that regulations require them to approve only rentals of ventilators and prohibit them from purchasing them, which we found to be a misunderstanding of the regulations.

We recommended that the department clarify its rental policies with its field office staff to ensure that overpayments for DME rentals are not occurring.

***Department Action: Pending.***

The department states that it will issue guidance to its field office staff clarifying rental policies.

**Finding #3: The department has not kept its codes and prices current and may not be receiving the lowest rates offered by providers or manufacturers.**

The department has been lax in updating its prices for items with MAPCs, and it may not be getting the same rates offered by providers or manufacturers to the general public. Specifically, we found the following:

- While technology improvements have made some items less expensive, the department has been lax in updating its prices for these items, and may be missing out on savings opportunities on these items. For example, the department issued only 10 operational instructional letters to its fiscal intermediary in the past three years. Of these 10 letters, only 4 actually updated a price on file, and those updates affected the MAPC for only seven of thousands of product codes for DME, medical supplies, and hearing aids.
- The department may be hampered in updating DME and hearing aid rates on a timely basis because these rates are established in regulations. In order to change these rates, the department must initiate and obtain approval for a change to the regulations, which can be a lengthy process.
- Although state regulations require the department to update its medical supply rates no less than every 60 days, on average for those medical supply product codes billed during fiscal year 2001–02, the department allowed 5,720 days, or about 15.5 years to elapse between price updates. This could potentially cost the department money. For example, we found that for two product codes the department could save an additional \$911,000 by making sure to update its prices in fiscal year 2002–03.

For those items for which it has established maximum allowable product costs, the department should ensure that it reviews and updates these rates on a regular and frequent basis. Further, to enable the department to become more responsive to changes in prices, the department should seek legislation to remove prices for DME and hearing aid items from regulations.

***Department Action: Pending.***

While the department believes that it makes every effort to update prices on a regular basis, it agrees that it has an opportunity to improve on the frequency of these updates. However, the department did not address how it will specifically address this recommendation.

**Finding #4: The department has not fully considered the challenges and costs of implementing its cost-savings plans.**

To combat the rising costs of DME and medical supply items, the department plans to implement the following two cost-savings measures in the near future:

- The department hopes to convert its medical supply codes from the current federally required billing code structure to the more detailed universal product number (UPN) codes to gain more relevant and timely information on the products it pays for.
- The department plans to implement negotiated contracts for some DME and medical supply items.

While both plans could potentially reduce the department's costs, both could also increase expenditures if the department fails to properly plan and support these actions—yet the department's plans remain vague, incomplete, and unfocused. For example, the department has not discussed its contract negotiation plans with providers or manufacturers who may prove to be resistant to the department's efforts.

In order to realize future cost savings for Medi-Cal, the department should continue to develop and use a UPN structure for medical supplies and contract negotiations for its DME items. However, the department should ensure that it adequately plans and considers possible limitations of its efforts. Further, the department should bring manufacturers and providers into its planning sessions as soon as possible.

***Department Action: Pending.***

The department states that it has plans to meet with provider associations and manufacturers of DME to obtain their input, suggestions, and support with contracting efforts.

# STATEWIDE FINGERPRINT IMAGING SYSTEM

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## ***The State Must Weigh Factors Other Than Need and Cost-Effectiveness When Determining Future Funding for the System***

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

*Our review of the California Department of Social Services' (Social Services) Statewide Fingerprint Imaging System (SFIS) revealed:*

- ☒ *Social Services implemented SFIS without determining the extent of duplicate-aid fraud throughout the State.*
  - ☒ *It based its estimate of the savings that SFIS would produce on an evaluation of Los Angeles County's fingerprint imaging system, rather than conducting its own statewide study.*
  - ☒ *Because Social Services did not collect key statewide data during its implementation of SFIS, we are not able to determine whether SFIS generates enough savings to cover the estimated \$31 million the State has paid for SFIS or the estimated \$11.4 million the State will likely pay each year to operate it.*
  - ☒ *In deciding whether to continue SFIS, the Legislature should consider the benefits SFIS provides as well as what appears to be valid concerns regarding the system, such as the fear it may provoke in immigrant populations eligible for the Food Stamp program.*
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**REPORT NUMBER 2001-015, JANUARY 2003**

**Department of Social Services' response as of December 2002**

Chapter 111, Statutes of 2001, directed the Bureau of State Audits (bureau) to conduct an audit of the Department of Social Services' (Social Services) Statewide Fingerprint Imaging System (SFIS). This system was designed to detect duplicate-aid fraud. The bureau was asked to report on the level of fraud detected through SFIS; the level of fraud deterrence resulting from SFIS; SFIS's deterrence of eligible applicants, especially the immigrant population, from applying for public benefits; and SFIS's cost-effectiveness.

### **Finding #1: Social Services did not know the extent of duplicate-aid fraud before implementing SFIS.**

Before SFIS was in place, estimating how much duplicate-aid fraud actually existed in the State was difficult. Social Services was aware only of potential cases of duplicate-aid fraud that the counties brought to its attention. The methods the counties used to detect duplicate-aid fraud prior to SFIS met the federal requirement and were similar to those used in other states. According to our survey, the counties used computer matches as the primary method to detect possible duplicate-aid fraud, followed closely by tips from concerned citizens or other organizations. Data from the counties responding to our survey regarding the number of duplicate-aid fraud cases identified prior to the implementation of SFIS did not suggest to us that duplicate-aid fraud was a serious problem.

Social Services had a few options available for determining the known extent of duplicate-aid fraud in the State prior to implementing SFIS. For example, it could have surveyed the counties as we did or requested counties to analyze their Integrated Earnings Clearance/Fraud Detection System and

DPA 266 data to determine the extent of duplicate-aid fraud. The DPA 266 is a report that tracks, among other things, statewide statistics on duplicate-aid investigation requests.

We raised concerns regarding the accuracy and completeness of the DPA 266 in our March 1995 report, titled *Department of Social Services: Review and Assessment of the Cost Effectiveness of AFDC Fraud Detection Programs*. Social Services has not resolved fully its problems with the DPA 266. Our survey results indicate that the counties do not report information consistently on the DPA 266, and therefore it is an unreliable report.

According to the chief of its fraud bureau, Social Services no longer verifies the accuracy of the information the counties report, because it does not consider the DPA 266 to be a statistical or claiming document but merely an activity report. However, this statement is inconsistent with Social Services' instructions for completing the DPA 266, which state that information collected on the DPA 266 is used to prepare a federal program activity report and special reports for the Legislature. Specifically, federal regulations require state agencies to submit to the United States Department of Agriculture (USDA) an annual program activity statement that includes data on investigations of fraud. If Social Services had captured more detailed and reliable data using the DPA 266, it may have been able to present a clearer picture of the extent of duplicate-aid fraud identified by the counties.

To ensure that it reports accurate and complete information to the USDA, Social Services should require the fraud bureau to incorporate the review of DPA 266 data into its on-site visits to counties.

***Department Action: Pending.***

Social Services stated that it will add this function to its visits.

**Finding #2: During implementation, Social Services missed its opportunity to determine SFIS's cost-effectiveness.**

Social Services and the Health and Human Services Agency Data Center (data center) did not capture critical data during the implementation phase that would have allowed them to quantify the savings attributable to SFIS. For example, each month two randomly selected groups of cases would be drawn from a subset of counties implementing SFIS over a six-month

period to establish a control group and an experimental group of recipients. Individuals in the control group would not be fingerprinted, but individuals in the experimental group would be fingerprinted. Then the amount of benefits paid to each group in the first calendar month in which SFIS had its full effect on the experimental group would be used to calculate an initial savings amount. The recidivism rate—the rate at which individuals previously terminated from receiving aid return to aid—would be tracked for each county for one year and used to adjust the initial savings.

The deputy director of Social Services' Welfare-to-Work Division told us that in mandating SFIS, the Legislature did not provide any statutory authority or resources to require counties to collect data. Although we agree that state law mandating SFIS neither explicitly mandates the collection of data nor provides funding for these efforts, it does require Social Services and the data center to design, implement, and maintain the system. Moreover, other state laws and policies establish the State's expectations for implementing information technology (IT) projects. For example, state law holds the head of each agency responsible for the management of IT in the agency that he or she heads, including the justification of proposed projects in terms of cost and benefits. Further, state policy requires agencies to establish reporting and evaluation procedures for each approved IT project and to prepare a post implementation evaluation report that measures the benefits and costs of a newly implemented IT system against the project objectives. The State does not consider a project complete until the Department of Finance approves the post implementation evaluation report. Data collection is a key component in preparing this report. Therefore, the data center and Social Services were remiss in not bringing the lack of authority and resources to the Legislature's attention so they could effectively implement SFIS. Moreover, because counties did not begin to use SFIS until March 2000, roughly four years after the passage of the law, it is reasonable to conclude that the data center and Social Services had ample opportunity to do so.

To ensure that its implementation of future IT projects meets state expectations, Social Services and the data center should collect sufficient data to measure the benefits and costs against the project objectives. They also should identify promptly any obstacles that may prevent them from implementing effectively the project.

***Department Action: Pending.***

Social Services and the data center stated that they will continue to adhere to all appropriate IT policies and processes, and identify obstacles that may prevent an appropriate analysis of impacts of the IT project.

**Finding #3: Incomplete cost data and a flawed method for estimating savings renders Social Services' cost-benefit analysis for SFIS unreliable.**

Social Services tracks some of the costs associated with SFIS, but it does not track county administrative costs. As a result, it does not know the full costs of operating SFIS. Further, because Social Services did not capture the data necessary to determine the savings attributable to SFIS during its implementation, Social Services developed an estimate based on the results of Los Angeles County's AFIRM demonstration project. However, the methodology it used to estimate the State's savings of roughly \$150 million over five years for SFIS is flawed and therefore unreliable.

Although we were able to substantiate the data center's and Social Services' costs, we were not able to determine the counties' actual costs because Social Services did not require counties to track SFIS administrative costs separately. Social Services estimated that the total administrative costs that all counties except Los Angeles incurred for CalWORKs and the Food Stamp program for fiscal year 2000–01 would be roughly \$1.8 million, yet Riverside County told us that its estimated costs for the same fiscal year were roughly \$1.4 million; Riverside County alone estimated its costs as amounting to 78 percent of the costs Social Services estimated for 57 counties. Additionally, Social Services' estimate does not include the cost that counties incur for investigating possible fraudulent activity. Furthermore, Social Services chose not to include any administrative costs for Los Angeles County in its estimate because the county had not yet implemented SFIS. Therefore, Social Services may be understating the cost of implementing and operating SFIS substantially.

Social Services' November 2000 estimate also attempts to quantify benefits or savings that would accrue to the CalWORKs and Food Stamp programs. The estimate does not include savings attributable to the avoidance of duplicate-aid fraud in the Food Stamp program because the data was not available. Further, Social Services did not include savings resulting from Los Angeles County's use of SFIS because the



county was not yet using SFIS when Social Services built the estimate. Finally, Social Services used data from Los Angeles County's demonstration project to support key assumptions in its development of the SFIS savings estimate, which is inappropriate because it assumes that these conditions hold true in other counties. In fact, Social Services was unable to provide documentation to support some of its key assumptions.

To improve its management of SFIS, Social Services should identify the full costs of operating SFIS by requiring counties to track their administrative costs separately. To ensure that its estimates are representative of the entire state and its key assumptions are defensible, Social Services should study the conditions of a sample of counties instead of assuming that conditions in one county hold true in other counties and maintain adequate documentation, such as time studies or other empirical data to support its estimates.

***Department Action: Pending.***

Social Services disagreed that it should separately track SFIS administrative costs, stating that these costs are included in general eligibility determination activities in the State's federally approved cost allocation plan. Social Services' failure to recognize the importance of these costs causes us concern. Until Social Services understands the total cost of operating SFIS, the State cannot properly evaluate the system in terms of costs and benefits.

Social Services agreed that maintaining adequate documentation to support its estimates is important and asserted that it has processes in place to assure that assumptions are appropriately documented.

Social Services did not state clearly the actions it will take to address our recommendations. It is our expectation that Social Services will provide a corrective action plan in its 60-day response, which is due March 2003.

**Finding #4: The majority of matches SFIS identifies are administrative errors, and the actual level of fraud it detects is quite small.**

Although Social Services does not know how many applicants SFIS deters from attempting to receive duplicate-aid, it can determine the number of applicants that SFIS detected who



were attempting to receive duplicate aid. However, we found that the actual number of matches SFIS has identified as possible fraudulent activity is substantially fewer than the number of matches it identifies as administrative errors made by county staff. Between March 1, 2000, and September 30, 2002, SFIS detected a total of 25,202 matches, 7,045 which were still pending resolution as of September 30, 2002. Of the remaining 18,157 items with a final disposition, staff identified only 478 of the items, or roughly 3 percent, as possible fraud situations. Further, investigators found fraud in only 45 of the 478 possible fraud items, just 0.2 percent of the 18,157 items resolved, according to SFIS reports. In order to determine how long items had been pending resolution, we asked for an aging report as of October 21, 2002. We found that roughly 3,000 of the 4,920 matches shown as pending resolution in SFIS were more than 99 days old, and 1,100 had been pending for a year or more. Social Services told us that it generates monthly reports from SFIS that allow it to see whether counties are investigating and resolving discrepancies but that it reviews these reports in detail only twice a year. Moreover, although Social Services provides training and instructs counties to promptly resolve any matches that SFIS identifies, it does not have a regulation, policy, or set of procedures requiring counties to do so. Additionally, Social Services has yet to develop written procedures for its own staff to follow when reviewing reports that SFIS generates. Without policies and procedures, Social Services cannot ensure that SFIS information remains current, which can diminish its usefulness.

To improve its management of SFIS, Social Services should establish policies and procedures that require counties to resolve pending items in the resolution queue promptly. Additionally, the fraud bureau should develop written procedures for its staff to follow up on items pending in the resolution queue. The procedures should include fraud bureau staff requesting a monthly aging report to use as a tool to determine whether items pending in the resolution queue are current and, if necessary, contacting the appropriate counties. Furthermore, Social Services should ensure that counties investigate and record the outcomes of their investigations in SFIS.

***Department Action: Pending.***

Social Services stated that it has already initiated action to develop a monthly aging report to use as a tool to determine if items pending in the resolution queue are current. Social Services also states that it will continue its efforts to ensure that counties promptly resolve pending items in the SFIS resolution queue, and will assess the need for developing written procedures for fraud bureau staff.

**Finding #5: Social Services does not collect the data it needs to determine if it is successful in reaching its Food Stamp program target populations.**

California's Legislature voiced its concern over low participation rates by requiring Social Services to develop a community outreach and education campaign to help families learn about and apply for the Food Stamp program. In an annual report to the Legislature dated April 1, 2002, Social Services stated that it believes its outreach efforts have had an effect on increasing the number of applications received and the caseload of the Food Stamp program. However, the Legislature specifically instructed Social Services to identify target populations and report on the results of its outreach efforts. Social Services identified two target populations: families terminating from CalWORKs and legal noncitizens. Although Social Services recognizes that the ultimate measurement of its outreach efforts' success depends on its ability to reach the target population, it did not collect data to evaluate the participation rates of these two populations. Instead, it chose to rely on the USDA's report of estimated state Food Stamp program participation rates, which presents information that is up to three years old. Furthermore, the USDA's report does not have information specific to Social Services' target populations. Therefore, Social Services does not know if its efforts to reach legal noncitizens have been successful.

To report accurately the results of its community outreach and education efforts to the Legislature, Social Services should establish a mechanism to track the participation rates of the target populations.

***Department Action: Pending.***

Social Services agreed that a mechanism to track participation rates of target populations would provide useful information to judge the results of community outreach and education efforts. It stated that the extent to which it will be able to continue or expand these efforts is contingent on resource availability (both staffing and funding).

**Finding #6: Decision makers should consider the benefits and drawbacks of SFIS when deciding future funding for the system.**

The primary benefits that the State derives from continuing to use SFIS are the proven effectiveness of fingerprint imaging technology to identify duplicate fingerprints and its ability to identify applicants who may travel from county to county seeking duplicate aid. However, several factors could also support discontinuing the use of SFIS. For one, the State is spending \$11.4 million or more annually to operate SFIS without knowing the actual savings that it may be producing. Additionally, although we were not able to verify some of the concerns that opponents of SFIS raised, other concerns appear valid. For example, the fingerprint imaging requirement may add an element of fear to the welfare application process and thus may keep some eligible people from applying for needed benefits. The State must weigh these factors in deciding whether to continue to fund SFIS.

The Legislature should consider the pros and cons of repealing state law requiring fingerprint imaging, including whether SFIS is consistent with the State's community outreach and education campaign efforts for the Food Stamp program. To assist the Legislature in its consideration of the pros and cons of repealing state law requiring fingerprint imaging, Social Services and the data center should report on the full costs associated with discontinuing SFIS.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing this recommendation.

***Department Action: Pending***

Social Services agreed, but stated that it has previously provided this information to the Legislature. Social Services did not state clearly the actions it will take to address our recommendation. It is our expectation that Social Services will provide a corrective action plan in its 60-day response to the audit, which is due March 2003.



# DEPARTMENT OF VETERANS AFFAIRS

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## ***Its Life and Disability Insurance Program, Financially Weakened by Past Neglect, Offers Reduced Insurance Benefits to Veterans and Faces an Uncertain Future***

REPORT NUMBER 2000-132, MARCH 2001

Department of Veterans Affairs' response as of March 2002

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

***Our review of the California Department of Veterans Affairs (department) life and disability insurance program (insurance program) revealed that:***

- ☒ ***Changes made in the insurance program to reduce its financial liabilities also reduced the program's benefits to veterans.***
- ☒ ***It is currently seeking to increase the insurance program's benefits, but the long-term costs and funding for increased benefits are uncertain.***

***In the short-term, it could fund increased benefits for veterans by using a limited amount of loan program funds and a modest increase in the premium rates it charges to veterans.***

***Improvements in its procedures are necessary to effectively manage the insurance program and safeguard its assets.***

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In conjunction with its California Veterans Farm and Home Purchase program (loan program), which provides low-cost home loans to veterans living in California, the California Department of Veterans Affairs (department) offers a life and disability insurance program (insurance program) to qualifying veterans. The insurance program is intended to provide adequate protection to veterans so that injury or illness will not stop them from making loan payments and so their surviving spouses can pay off all or some of the mortgage. At the request of the Joint Legislative Audit Committee (audit committee), we conducted an audit of the department's insurance program. The audit committee was specifically concerned about the department's management of the insurance program, including, but not limited to, the use of funds, the amount of premiums paid and coverage received by veterans, and future options for the program. The audit committee also requested that we review a study released in February 2001 by a certified public accountant on the department's use of mortgage bond proceeds from 1980 to 1996. Based on our review, we found the following:

**Finding #1: In June 1996 the department made sweeping changes to its insurance program, aiming to reduce the program's exposure to substantial estimated liabilities and restore financial stability. As of June 30, 2000, the department had not adequately identified and funded its remaining liabilities.**

The department reduced its future liabilities by transferring the majority of its insurance risk to a commercial insurer. However, the department continues to administer a relatively small self-funded plan for those veterans who were receiving disability benefits prior to the June 1996 change. As of June 30, 2000, the

department's estimates of liabilities for the self-funded plan totaled \$35 million, however, it has set aside only \$22 million in cash to pay for these liabilities. The department does not procure an annual actuarial study of its liabilities for the self-funded plan, instead it estimates its liability each year by adjusting a 1997 actuarial report using the number of loans and projected averages of outstanding loan balances for disabled veterans. The department acknowledges that its current method of estimating liabilities for the self-funded plan needs improvement. However, it believes it can reliably determine its liabilities without an actuarial study because the group of veterans in the plan is small and most are permanently disabled.

We recommended that the department ensure it is able to meet future liabilities for the current self-funded plan by revising its method for annually determining its liabilities and developing a long-term strategy to set aside sufficient cash.

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

The department reports that its future liabilities for its self-funded plan are diminishing and it is taking action to ensure it has sufficient funds to meet those future liabilities. The number of borrowers under the self-funded plan is declining partly due to normal loan payoffs. In addition, the department is actively seeking to pay off the loans of permanently-disabled contract purchasers who will accept payoff of their loan balances in lieu of ongoing monthly benefits, thereby, reducing the department's future liabilities.

After it completes all possible loan payoffs, the department reports it will review the economic feasibility of administering in-house all or some of the remaining permanently disabled contract purchasers in the self-funded plan. Further, the department is developing a methodology to calculate the amount of cash needed to fund the program annually.

**Finding #2: The department is exploring ways to improve its insurance program; however, unpredictable future costs and the changing demographics of California's veteran population may prove obstacles for the department when selecting options.**

The department plans to seek competitive bids from commercial insurers to obtain a wide range of options and associated costs. However, this would provide only a short-term solution because

any proposals the department receives will most likely be based on short-term agreements and will bring higher insurance costs to the program.

In addition, funding options for the insurance program depend on younger veterans qualifying for loans. However, an aging population of veterans in the loan program and a dwindling supply of money for home loans to younger veterans will drive up the costs of providing life and disability insurance to veterans in the loan program.

Finally, in choosing among alternative plans, the department faces a wide range of costs. These alternatives range from returning to a self-funded plan to terminating the insurance program. We estimate 30-year up front costs for these options range from almost \$270 million to no cost to the department, but most cost estimates do not include the \$35 million liability for those veterans who were receiving disability benefits before June 1996, now covered under the current self-funded plan.

We recommended that when choosing its option for the future of the insurance program, the department establish a long-term strategy for the program that does not adversely affect the financial health or marketability of the home loan program. Any long-term strategy that it develops should include consideration of the following:

- The aging population of the veterans in the loan program.
- The uncertainty of future funding for loans to younger veterans.
- The future costs of the insurance program beyond the five years any group insurance policy will cover.
- The discontinuance of the insurance program for veterans who entered the program after 1996.

In addition, the department should allow public comment and give interested parties an opportunity to present ideas for improving the insurance program and consider the public comments when identifying viable options for the program in order to best serve veterans.



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

In order to help ensure future funding availability, the department will continue to work with the other four states with veterans' mortgage programs to loosen federal restrictions on the proceeds of bonds used to finance veterans' home purchases. Current federal restrictions limit the amount of funds the department can loan to younger veterans, thereby, driving up the average age of, and the cost to insure, the current pool of veterans in the insurance program.

In addition, the department is working to solicit bids from insurers on a variety of options for the current life and disability benefits. The department plans to hold a public meeting to hear concerns on suggestions regarding the program and to complete the bid process by October 2002. By examining all the costs associated with insuring and administering the life and disability program, the department reports it will be able to make an informed decision regarding the long-term viability of the loan programs and its ancillary benefit program.

**Finding #3: The department has limited choices for funding the insurance program.**

The department estimates it can transfer approximately \$1.5 million each year in unrestricted funds from the loan program to the insurance program for up to 10 years. However, using the loan program's unrestricted funds for the insurance program will decrease the number of veterans who can receive home loans by about eight loans using current average loan amounts.

On the other hand, modest increases in insurance premiums can provide additional funding for the insurance program. A 10 percent increase in premiums to veterans raises the average monthly premium by \$4.23 but generates almost \$900,000 annually for the program. A 20 percent increase in premiums for the average veteran in the program raises the monthly premium by \$8.65, but generates almost \$1.8 million annually for the program.

Additionally, savings the loan program will achieve when the department implements its new administrative cost allocation system in June 2001, could be used to fund increases in the

insurance program's benefits. (Its current system has been inappropriately charging the loan program for the costs of administering the department's other programs.) These savings could be as much as \$1.3 million annually.

We recommended that when identifying potential sources of funds for improved insurance benefits to veterans, the department should consider modest and appropriate premium rate increases and continue to explore its options for transferring unrestricted funds to the insurance program. In addition, the department should finish implementing its new cost allocation system to ensure it charges only appropriate administrative costs to the loan program, identify the savings to the loan program, and consider using those savings to improve the insurance program.

***Department Action: Pending.***

The department reports that after its procurement process is complete, it can determine what additional funds may be needed and where to obtain those funds. The department states it has no objection to a slight increase in premiums, and will carefully study the feasibility of discontinuing the insurance program for future contract holders as mentioned in the audit report. Further, the department reports that it is nearing the final stages of the time study needed to implement its new administrative cost allocation system and by the end of calendar year 2002 it will have gathered the necessary data to properly allocate its administrative costs to the programs it administers.

**Finding #4: The department lacks measurable criteria for evaluating its consultant's contract performance.**

The department relies on its consultant for expert advice on managing the insurance program, but the consultant's contract lacks enough detail about the extent of services he must provide and specifics about the form he must use to present his results to allow the department to effectively monitor the contractor's performance. Without clearly defining in the contract what it requires of the consultant, the department limits its ability to monitor the consultant's progress and ensure that his work meets the necessary objectives and time frames for effectively managing the insurance program. Further, the department does not have firm policies and procedures in place for its contract

managers to follow. Without firm policies and procedures, the department has limited assurance that it complies with state guidelines for monitoring consultant contracts.

We recommended that the department ensure that its contracts reflect the level of service it requires from the contractors by following guidelines set forth in the State Contracting Manual and implement procedures for monitoring the contractor's performance.

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

The department reports it is working with its insurance consultant to ensure quarterly and annual reports are completed in a timely manner. In addition, the department's Contract Management Section has completed training its managers on the role of a contract manager. Training is intended to provide contract managers with a greater ability to develop and write clear, concise, detailed descriptions of the work that will be performed by the contractors, and provide knowledge of techniques to monitor contractual compliance and work performance.

**Finding #5: The department lacks adequate controls over cash transactions.**

The State Administrative Manual identifies certain duties that should not be performed by the same person because doing so creates an opportunity for theft. Nonetheless, the department allows one person in its insurance unit to perform some of these 'incompatible' tasks. In addition, because of staff vacancies, another person in the accounting unit sometimes performs incompatible duties.

We recommended that the department should protect its assets by ensuring that it establishes and maintains an adequate system of internal controls as set forth in the State Administrative Manual.

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

The department reports that it has reviewed its internal controls and corrected the deficiencies in the separation of duties in the cashiering function. In addition, the department created a detailed matrix of accounting and cashiering duties for routine monitoring of internal control requirements in the event of staff absences, vacancies, or reassignments.

# DEPARTMENT OF INSURANCE CONSERVATION AND LIQUIDATION OFFICE

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## ***Stronger Oversight Is Needed to Properly Safeguard Insurance Companies' Assets***

REPORT NUMBER 2001-102, JULY 2001

Department of Insurance Conservation and Liquidation Office's  
response as of July 2002

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

*Our review of the operations and internal controls of the Department of Insurance's (department) Conservation and Liquidation Office (CLO) disclosed that the CLO:*

- ☒ *Does not adequately safeguard and conserve assets that come under its control.*
- ☒ *Has not updated estate closing plans since 1998, and has never included projected cash flow needs in these plans.*
- ☒ *Does not effectively manage its contracts and its basis for allocating certain costs to insurers' estates is inequitable.*
- ☒ *Has never adopted a comprehensive conflict-of-interest policy for its employees and contractors to follow.*

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The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits to conduct an audit of the operations of the Department of Insurance's (department) Conservation and Liquidation Office (CLO). Specifically, the audit committee asked us to determine whether the CLO has adequate internal controls to detect the mishandling of the assets of conserved and liquidated insurers. The audit committee also asked us to evaluate the sufficiency of the department's efforts to regularly monitor all CLO operations. We found that:

### **Finding #1: The CLO does not promptly identify and secure all assets of seized or conserved insurers.**

The Conservation and Liquidation Office (CLO) does not follow recommended procedures when it inventories the fixed assets of an insurance company (insurer) that it seizes or places in conservation. In a recent example, rather than immediately completing an inventory to identify and safeguard the assets of a seized title insurance company, the CLO waited to do so until at least three weeks after it was authorized to take control of the insurer in February 2000. More recently, the CLO omitted several items from the inventory count of another conserved insurer's fixed assets. In addition, the CLO does not account for all of the assets of liquidated insurers after they are auctioned, so it does not know whether the auction company returns all of the unsold items. Such practices fail to safeguard and conserve the insurer assets that come under the CLO's control.

To ensure that it adequately safeguards the fixed assets of insurers under its control, we recommended that the department see that the CLO take the following steps:

- ☑ *Spent at least \$6 million of insurers' money on a claims processing system that does not meet its needs.*

*Additionally, the department has allowed the CLO to continue its poor management practices by failing to properly oversee its activities.*

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- Develop work plans for each inventory it conducts, based on prudent business practices that include:
  - ♦ Holding preparatory meetings to discuss the inventory process.
  - ♦ Providing instructions regarding how each inventory will be taken.
  - ♦ Promptly conducting inventory counts to reduce the risk of loss.
  - ♦ Ensuring that all count sheets are pre-numbered and collected after the inventory is complete.
  - ♦ Checking all counted items to ensure that they are clearly marked or tagged to avoid omitting any.
- Train its staff in proper inventory procedures and require all personnel who participate in the inventory process to follow the new procedures.
- In its contracts with auction companies, require auction lists of sold and unsold items to include the inventory tag number and the exact same description as is included on the CLO's list of inventory available for auction, and reconcile the lists to ensure that all inventoried items are accounted for.

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

The department states that the CLO has completed a review of its fixed asset inventory policies and procedures manual and made the necessary modifications to ensure that all of the above recommendations were properly included. The revised manual was finalized on September 10, 2001, and will be used for all future inventories.

**Finding #2: The CLO does not ensure that investment decisions are optimized.**

We found that the CLO is not as effective as it could be in managing insurers' invested assets and budgeting for its operations, because it does not regularly update the individual closing plans for the estates it manages. Since 1998, the CLO has failed to update its estate closing plans, and it has never included an estimation of each estate's future cash flows as part of those plans. This information would be very helpful to its investment

managers in maximizing the assets of the estates they manage. In 1998, the CLO did prepare an aggregate cash flow projection that aided its investment managers. Since then, however, the CLO has neither updated estate closing plans nor projected its cash flow needs, so this information has been unavailable for making investment decisions or to more accurately budget for its operations.

In addition, since 1995, the CLO has not reviewed its investment guidelines or performance benchmark to ensure that its investment strategy is appropriate, even though the size of its investment pool has more than tripled since then. In addition, in calendar year 2000, the CLO paid \$930,000 to its investment managers, but since 1998, it has not evaluated the fees it pays to ensure that they are reasonable when compared to what other investment firms would charge to manage a pool of similar value. Consequently, the CLO may be needlessly spending estate funds on fees for its investment managers.

To maximize the return on the assets it manages, we recommended that the department ensure that the CLO takes the following actions:

- Update estate closing plans and include estimates of the future cash needs for each estate. The CLO should use this information to ensure that it reaches its goal of maximizing estate assets and to accurately plan and budget for its operations.
- Periodically reevaluate its investment strategy and benchmark to reflect changing conditions and requirements.
- Periodically review its contract for investment management services to determine whether the fees it pays are reasonable compared to what other investment managers would charge to manage an investment pool of similar value.

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

The department states that the CLO has completed updating estate plans for the 55 estates under its control as of July 2001, and developed a schedule to keep them updated.

In March 2001 the CLO requested the current investment management firms to provide their recommendations for modifying the investment strategy, and in July 2001 decided not to modify the current strategy or benchmark until new cash flows were developed and the investment function was put out for competitive bid. In August 2001 the CLO issued a request for proposal for investment management services and has since selected new investment managers who are in the process of revising the investment guidelines. According to the department, the CLO will save \$300,000 annually under its new contract with the investment managers.

**Finding #3: The CLO did not always follow its procedures for awarding and managing contracts for professional services.**

The CLO does not adequately manage its contracts to ensure that contract managers follow its competitive bidding policy, which specifies only three circumstances when obtaining competitive bids is not required. Two of the 10 contracts we reviewed should have been competitively bid but were not, and the reasons the CLO gave for using sole-source contracts did not appear to qualify under any of the exceptions listed in its policy. When the CLO fails to properly control and monitor its contracts, estate assets may be spent improperly or unnecessarily.

We recommended that the department see to it that the CLO:

- Amend its contracting policies and procedures to define how managers should seek competitive bids, including the type of documentation required for bids obtained by telephone, and ensure that its contract managers understand and adhere to the CLO's contracting policies and procedures.
- Assign each contract a unique number and require its contract managers and accounting staff to track payments made using a spreadsheet or other means as a control against misapplied payments or overpayment.
- Review contracts periodically to determine if and when they should be renewed, and require all contractors to adhere to all contract terms and conditions.
- Ask one vendor who provided security services to pay back \$43,340 in overpayments due to the CLO paying a higher rate than its contract specified.

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

The department states that on September 12, 2001, the CLO completed a contracts manual that is based on the policies and procedures used by the department, including the requirement that each contract be identified with a unique number. The CLO plans to expand the manual to include detailed processes to be followed for the various methods used to procure services. In addition, the CLO established a contract coordinator position that is responsible for ensuring that the contracting policies and procedures are followed. Finally, the CLO sent a demand letter to the contractor that received the overpayment on July 27, 2001. The contractor agreed to pay back the overpaid amount in three equal installments with the last one occurring on December 2, 2001.

**Finding #4: The CLO does not ensure that it hires and promotes qualified staff.**

The CLO does not ensure that it hires and promotes the most qualified applicants. For example, the CLO hired two applicants and promoted one employee who did not appear to meet the CLO's minimum qualifications. Consequently, the CLO cannot be certain that it is employing the most qualified personnel, and it may be compensating some employees for qualifications they do not possess.

We recommended that the department see to it that the CLO hire qualified applicants and promote qualified employees to positions requiring technical knowledge and experience. In addition, the CLO should also verify applicants' references, including work and education records, before making hiring decisions and should document its justification when hiring applicants and promoting employees who do not meet minimum qualifications.

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

The department states that the CLO has established a formal process to ensure that individuals who are hired or promoted meet the minimum qualification requirements of the position classification, and that references, including work and education records are always checked. The new process is documented in the CLO's procedure manual.



**Finding #5: The CLO is not sure that its salary levels are still competitive.**

Although the CLO has obtained market trend reports for salary scales, it has not considered and evaluated this data. As a result, the CLO has not adjusted its structure for salary ranges since 1995. When the CLO does not periodically evaluate its salary structure, it cannot be sure that its salaries are reasonable and remain competitive enough to attract and retain qualified applicants.

To ensure that its salaries remain competitive, we recommended that the department have the CLO evaluate its salary structure, using both private and public sector comparisons, to ensure that it attracts and retains qualified employees.

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

The department states that the CLO retained a consultant and completed reviewing its salary structure. This evaluation included both private and public salary comparisons. According to the department, the CLO salary structure was finalized and implemented on December 28, 2001.

**Finding #6: The CLO has never established a comprehensive conflict-of-interest policy for its employees and contractors.**

The CLO has never had comprehensive conflict-of-interest policies and guidelines for its employees and vendor contractors to follow. Because it lacks comprehensive conflict-of-interest policies and guidelines, the CLO cannot ensure that its employees and contractors adequately safeguard sensitive information and act in the best interest of the estates it manages.

We recommended that the department instruct the CLO to:

- Finalize, approve, and implement a conflict-of-interest policy similar to the policy used by state agencies.
- Require all designated employees and multiyear contractors to complete an annual conflict-of-interest statement.

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

The CLO has drafted its conflict-of-interest code and statement of incompatible activities, submitted it to the Fair Political Practices Commission, and is in the process of implementing it for use. According to the department, all designated CLO employees and multiyear contractors have completed an annual disclosure form.

**Finding #7: The CLO's basis for allocating fixed costs unfairly burdens some insurers.**

We found inequities in the CLO's basis for allocating its fixed costs to estates. Moreover, the CLO does not regularly review the status of estates to identify those that meet its criteria for sharing the fixed costs. For example, we found that for one estate the CLO did not allocate more than \$4,000 for one month's fixed costs despite the fact that staff spent 94 direct hours working on this estate's activities.

We recommended that the department have the CLO:

- Review other options for allocating fixed costs to insurers that are more equitable than its current method, and implement a method that allocates fixed costs to all insurers' estates with assets that benefit from these costs.
- Develop a system of review to ensure that insurers who should be paying a portion of the fixed costs are included in its allocation process and that insurers who should not be included are not paying these costs.

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

The department states that the CLO has reviewed the various types of costs that need to be allocated to insurers' estates and has worked with the department to finalize a methodology for allocating these costs. The department approved CLO's allocation method in December 2001 and it became effective on January 1, 2002. The department also states that as new costs are incurred or estates come under the CLO's control, it will evaluate the appropriateness of the cost allocation system for those costs and estates.

**Finding #8: The CLO spent millions in estate assets to implement a claims processing system that does not effectively support its operations.**

Although the CLO has spent more than \$5.7 million to implement the claims processing system it purchased in 1995, the claims system continues to be costly and inefficient, and it does not effectively support the CLO's operations. For example, although the claims system was purchased in part to improve the CLO's reinsurance claims process, reinsurance recovery claims continue to be handled manually—a process that is inefficient and prone to error. Unless the CLO properly accounts for all of its reinsurance contracts and establishes receivables for all amounts due, it cannot ensure that it bills for all the reinsurance it is entitled to and promptly collects payments owed to avoid losing interest earnings because of delayed reinsurance payments, thus providing fewer funds to pay the insurance companies' creditors.

We recommended that the department instruct the CLO to:

- Work diligently toward defining its overall claims processing system needs. If it chooses to purchase a new claims processing system, the CLO should explore the option of alternative procurement, whereby the software company would have a direct financial stake in the successful implementation of the claims system.
- Ensure that reinsurance claims are both properly accounted for and promptly billed.

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

The CLO issued a request for proposal on August 10, 2001, to acquire the necessary assistance to find a solution to the CLO's overall claims processing and reinsurance collection needs. The CLO states that a firm was selected and began working in December 2001. According to the department, the work will be done in three phases. As of November 2002, the department reported that it has begun implementation of the second phase.

As of January 1, 2002, the CLO had reviewed its system and processes for promptly identifying and collecting on reinsurance claims and made appropriate modifications to procedures based on the results of the review. In addition, the CLO is in the process of obtaining a suitable proposal for assistance in maximizing the recovery of reinsurance. So far, this effort has been unsuccessful but the CLO stated that it would continue to assess the feasibility of this project.

**Finding #9: The department's flawed oversight of the CLO weakens its ability to ensure that the CLO properly safeguards and manages estate assets.**

Although the department considers the CLO to be exempt from several components of the State's control system, it has failed to take the steps necessary to otherwise oversee the CLO's activities. For example, although the CLO's internal auditor acts as an oversight arm for the department, it does not require the internal auditor to adhere to the department's policy that requires a two-year internal audit cycle. In fact, the current audit plan does not have the internal auditor completing his first audit cycle until 2002—nearly five years after its start. Consequently, the internal auditor has not yet reviewed the CLO's operations in some important areas, such as its processes for inventorying the assets of the insurers it manages, preparing budgets, and the operation of its information systems. Had the department enforced its policy, some of the weaknesses we detected might have been identified and corrected sooner.

We recommended that the department:

- Strengthen its oversight process by ensuring that the CLO's accounting and administrative controls are periodically monitored and the highest-risk areas are promptly reviewed by requiring the internal auditor to complete a full audit cycle at least once every two years.
- Ensure that when the CLO's internal auditor reports on control weaknesses and recommends improvements, the CLO implements such recommendations or documents why it does not.

- Follow up on the CLO's efforts to implement recommendations for improvement made by external auditors and ensure the status of those efforts is regularly reported.

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

The insurance commissioner (commissioner) established an audit/oversight committee that will meet quarterly and have full access and oversight of the operations of the CLO. This committee's duties will include such things as the CLO budget and all audit activities and other functions requested by the commissioner. The committee held its first oversight meeting on September 13, 2001.

To ensure that the CLO's accounting and administrative controls are periodically monitored, the CLO will have the Department of Finance complete an internal control review once every two years and high-risk areas will be reviewed by CLO internal audit staff. The office of the internal auditor was moved within the department and now reports directly to the chief deputy insurance commissioner. Additionally, the audit/oversight committee will review the CLO audit plan.

To ensure the accurate and prompt follow up and implementation of both internal and external audit recommendations, the department states that it has made several changes, including formalizing follow-up procedures for implementing recommendations and reporting on progress to the audit committee and executive staff of the department and CLO.

# PORT OF OAKLAND

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## ***Despite Its Overall Financial Success, Recent Events May Hamper Expansion Plans That Would Likely Benefit the Port and the Public***

REPORT NUMBER 2001-107, OCTOBER 2001

Port of Oakland's response as of December 2002

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

*Our review of the Port of Oakland's (Port) financial statements for the past 10 years and its past and future capital improvement projects revealed that:*

- ☒ *Overall, the Port effectively managed its assets, and its \$1.7 billion capital improvement program should benefit the public and allow it to remain competitive.*
  - ☒ *Its maritime and aviation divisions have prospered, and their expansion plans are based on reasonable estimates of future revenues and expenditures.*
  - ☒ *Certain recent events may hamper the aviation division's plans to improve the airport.*
  - ☒ *The real estate division consistently operated at a deficit due to unsuccessful business ventures, inaction in controlling operating costs, and the Port's decision to lease certain properties at below-market rates.*
- 

Overall, the Port of Oakland (Port) effectively managed its assets over the last 10 fiscal years (1990–91 through 1999–2000) and its \$1.7 billion capital improvement program should benefit the public and allow the Port to remain financially competitive in the future. We found that two of the Port's three revenue generating divisions—maritime and aviation—performed well during the past decade, while the third—real estate—has shown consistent losses. The real estate division's losses were due to some unsuccessful business undertakings, its inability to control its high operating costs, and the Port's decision to lease certain real estate division holdings to public and nonprofit entities at below-market rates.

The Port is also in the middle of planning and implementing large capital expansion plans for both its maritime and aviation divisions. Our review of the Port's March 2000 feasibility study found that projections of the maritime and aviation divisions' future revenues and expenses are reasonable and that their respective expansion plans should provide a number of public benefits. However, events have occurred since the March 2000 feasibility study that may significantly affect the aviation division's plans for improving the airport. For instance, the aviation division had to revise its expansion plan to curb costs when updated construction cost projections proved higher than expected. In addition, an appellate court decision will require the Port to develop a supplemental environmental impact report that will result in added time and expense. Finally, the terrorist attacks of September 11, 2001, could result in costly changes to airport security.

**Finding: The real estate division's consistent losses have been due to costly public services, high operational expenses, and some ill-fated business decisions.**

Despite two studies and an action plan adopted by the Board of Port Commissioners (board), the real estate division has taken few steps to alleviate the financial drain it has had on the Port's overall operations. From fiscal year 1990–91 through 1999–2000 the real estate division lost between \$4.3 million and \$12.4 million, for an average annual loss of \$7.5 million. These losses appear to result from at least three different factors. The first is a conscious decision by the Port to have the real estate division enter a number of lease agreements at rates significantly below fair market value. The second relates to the high operational costs associated with properties located in and around Jack London Square, costs that the real estate division failed to reduce. The third cause seems to be some ill-fated decisions the division made in pursuing certain business deals.

We recommended that, to reduce the effect of its losses on the Port's overall operations, the real estate division should take the following actions:

- Complete the action plan to improve revenues and reduce operating costs that was approved by the board in 1999.
- Examine the feasibility of increasing below-market lease rates to at least cover its operational costs without harming the Port's relationships with the community and the other municipalities.
- Continue to look for ways to increase revenues and decrease costs associated with managing its assets.

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

The Port reports that its real estate division has accomplished several items included in its 1999 action plan and is currently working towards completing several others. Specifically, the division has sold four buildings in Jack London Square and entered into a management agreement to transfer the management of the entire Jack London Square portfolio to a partnership group. The Port stated that this transaction should improve the operational efficiencies of the real estate division. The division is also moving forward with the phase II development of Jack London Square and recently released a request for proposal for a management company to take over managing the division's Marina portfolio of properties.

Further, the Port reports that its real estate division is not going to pursue any new “below market” transactions and will attempt to restructure its leases with the city of Oakland as opportunities arise for land being used for municipal services. However, the Port stated it does not feel that restructuring the below market leases related to public access and recreational benefits as a way to increase the division’s revenue would be feasible. Finally, the real estate division reported land sales totaling \$19.5 million in fiscal year 2001–02 and \$5.6 million thus far in fiscal year 2002–03. The Port stated that the proceeds of all such sales would be used to fund the real estate division’s capital improvement and infrastructure projects.





# SAN DIEGO UNIFIED PORT DISTRICT

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## ***It Should Change Certain Practices to Better Protect the Public's Interests in Port-Managed Resources***

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

*Although many San Diego Unified Port District (Port) actions we reviewed were in accordance with state law and Port policies, we noted the following exceptions:*

- ☑ *The Port did not disclose that it offered below-market rental payments to one hotel, potentially lowering the Port's revenue by \$7.4 million over 10 years.*
  - ☑ *For three major developments, the Port did not seek competition by issuing requests for proposals or qualifications.*
  - ☑ *The Port's contracting practices sometimes do not ensure fair and open awards of its contracts and purchases.*
  - ☑ *The Port lacks postemployment guidelines for its officials and often failed to meet its timelines for employee discipline appeals.*
  - ☑ *The Port can improve its compliance with open meeting laws.*
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### **REPORT NUMBER 2001-116, APRIL 2002**

#### **San Diego Unified Port District's response as of October 2002**

**T**he Joint Legislative Audit Committee requested that we review the San Diego Unified Port District's (Port's) contracting and personnel policies and procedures as well as the public's access to the Port's records and decision-making process.

#### **Finding #1: The Port has not always done enough to seek fair market value in its leases.**

The Port earns some of its revenue by leasing the property it manages around the San Diego Bay (bay). Contrary to its leasing policies, when the Port signed a lease with one of its hotels in 1995, it granted a below-market rate for 10 years and did not disclose that it was doing so. The below-market rate may result in the Port receiving \$7.4 million less in rental payments over a 10-year period.

The Port may also be charging below-market rates to the marinas around the bay. When setting rental rates, the Port rejected rates suggested by an independent appraiser. Instead, the Port selected an appraisal methodology that did not consider rents paid by comparable properties, such as the City of San Diego's Mission Bay marinas. As a result of its decision to adopt a methodology that did not consider rates paid by nearby marinas, Port revenues between July 1999 and June 2001 were approximately \$600,000 lower than what they would have been had they used an alternative methodology.

We recommended that the Port obtain market value rent when awarding leases or disclose and provide appropriate justification for offering below-market rent when the Board of Port Commissioners (board) considers approval of the lease. We further recommended

that the Port consider adopting an appraisal methodology for its marinas that combines economic analysis with a review of rents paid on comparable properties.

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

The Port created an advisory committee to review the Port's proposed policies governing real estate leases and rentals. The advisory committee recommended changes to the proposed policies and administrative practices. Both of these documents call for market value rent but the board would retain the right to grant rent discounts, waivers, or other concessions. In addition the proposed administrative practices call for using appraisals that comply with the *Uniform Standards or Professional Appraisal Practice* to assist in determining market rent for new flat-rent leases and for rent reviews in existing leases. The Port placed these proposed policies on the board's November 5, 2002 agenda.

**Finding #2: The Port pursued some major development projects without publicly soliciting proposals.**

The Port did not issue requests for proposals or qualifications on three major development projects and therefore may have missed opportunities to receive additional proposals from qualified developers. For one hotel development project, the Port chose to conduct a negotiating session over a holiday weekend, instead of issuing a request for proposals or qualifications. In another case, the Port received four unsolicited proposals to develop a hotel on Harbor Island but did not issue a request for proposals or qualifications to identify other interested parties. The Port also chose not to issue a request for proposals or qualifications for a third development project because it believed a tenant with a lease on an adjoining property would be best suited for the development. By not using a more open and competitive process for developing these projects, the Port has made itself vulnerable to claims that it has acted unfairly and not in the public's best interests.

We recommended that the Port solicit competition through requests for proposals or qualifications when developing major projects, unless there is a compelling public interest not to do so.

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

The Port agrees with our recommendation and has included this issue in its proposed policies that it placed on its board's agenda in November 5, 2002.

**Finding #3: The Port's contracting practices do not always match its policies or follow best practices**

Some of the Port's actions in awarding contracts and making purchases have not been in line with best practices or its own policies. The Port amended two information technology contracts totaling more than \$1.7 million when significant changes in the scope of work indicated that the projects should have been bid separately and issued as separate contracts. Because it did not open this work to the competitive bidding process, the Port denied other consultants the opportunity to compete for these projects and has no assurance that it obtained the services at the best possible price and terms.

In addition, we found that the Port did not apply best practices in awarding the \$1.6 million contract because it allowed the consultants that had helped develop the requirements for the project to also bid on that project. Prudent practices would not allow consultants to bid on projects for which they had developed the requirements because it leaves the Port open to claims of favoritism and unfair competition.

In addition, because the purchasing department treated service contracts according to the approval rules for supply purchases, certain service purchase orders between \$50,000 and \$75,000 did not receive the board approval that Port policy required. The purchasing department was also failing to notify the board of service purchase orders between \$25,000 and \$50,000 as required by Port policy. Without board approval or notification, commissioners missed the opportunity to provide some oversight of these contracts or request additional information when they had questions.

We recommended that the Port competitively bid new contracts instead of amending existing contracts when the scope of work changes significantly. We also recommended that the Port adopt a policy that would prohibit contractors that have developed

specific requirements for a project from subsequently bidding on that project. We further recommended that the Port follow its policy requiring board notification and approval of certain service purchases.

***Port Action: Corrective action taken.***

The Port agrees that it should bid new contracts instead of amending existing contracts when the scope of work changes significantly and is now reviewing each contract to ensure compliance. The Port has revised its policies to prohibit contractors that have developed specific requirements for a project from subsequently bidding on that project. Also, the Port reports that it is now complying with board policies concerning board involvement in approving contracts.

**Finding #4: The Port needs to better adhere to conflict-of-interest laws and may need to adopt additional guidelines.**

The Political Reform Act of 1974 requires that public officials disclose personal interests that might be affected while performing their duties and also requires that they disqualify themselves from any governmental decisions that would affect their financial interests. We found that one commissioner did not report real estate within two miles of the Port's jurisdiction as required by law. Although he corrected the error in his fiscal year 2001–02 disclosure statement, we believe that the Port's commissioners and employees required to file disclosure statements should reexamine their statements to ensure that they are complete and accurate.

Furthermore, although both the federal and state government have adopted post-employment guidelines for elected officials and government employees, the Port's conflict-of-interest policy does not include similar requirements for its officials. As a result, the Port has left itself open to claims that the actions of its exiting and former officials could constitute an improper influence on Port decisions. In particular, a former commissioner represented several clients in actions before the board less than a year after leaving the board.

We recommended that the Port encourage its commissioners and employees that file disclosure statements to review their current and past statements for completeness and accuracy. We

further recommended that the Port consider adopting post-employment guidelines similar to those in place at the State and federal levels.

***Port Action: Corrective action taken.***

The Port has adopted a comprehensive ethics code that contains post-employment restrictions that are more restrictive than those of the Fair Political Practices Commission.

**Finding #5: The Port has not always followed its policies and procedures for appeals of personnel actions.**

The Port does not always conduct appeals of personnel actions as required in its rules and regulations. Based on our review of employees' appeals of disciplinary actions, we found that the Port almost always exceeds the time frames established in its appeal procedures. Because these procedures cause the Port's employees to have certain expectations about how the Port will act on disciplinary appeals, it is important for the Port's practices to match its policies.

We recommended that the Port ensure that personnel appeals are conducted according to Port procedures.

***Port Action: Corrective action taken.***

The Port has revised its policies and procedures to ensure that it either complies with timelines or documents employees' consent when extensions of time are granted.

**Finding #6: The Port can improve its compliance with open meeting laws.**

The Ralph M. Brown Act (Brown Act) states that a local legislative body may not take action or discuss any item that has not been publicly identified in the agenda or added by a vote of the body. However, in one instance, the board discussed an issue in closed session even though it had not given appropriate notice that the issue was being continued from a prior meeting. The impact on the public's access to the decision-making process was mitigated by the fact that the board did not act on this and one other issue at the meetings where they were discussed. In

addition, we found three instances in which the Port's agenda descriptions for closed-session personnel discussions failed to provide sufficient information to meet the requirements of the Brown Act.

The Brown Act also allows local legislative bodies to recover their costs for providing agendas to individuals or groups that request an agenda be sent to them before each meeting. However, the Brown Act indicates that the fee charged cannot exceed the costs of providing the service. Yet the Port has not analyzed its costs for providing this service in over 10 years, even though it now faxes most agendas instead of mailing them. Without this analysis, the Port cannot ensure that the fees it charges for providing this service do not exceed the costs it incurs.

We recommended that the Port ensure it properly notifies the public of all board discussions, as required by state law. We further recommended that the Port reevaluate the fees it charges for distributing agendas to ensure the fees do not exceed the cost of distributing the agendas.

***Port Action: Corrective action taken.***

The Port agrees with the recommendation and has established additional procedures to ensure proper public notice of board discussions.

# DEPARTMENT OF CORRECTIONS

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## ***Investigations of Improper Activities by State Employees, July 2000 Through January 2001***

ALLEGATION I990136 (REPORT I2001-1), APRIL 2001

Department of Corrections' response as of March 2002

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

***Employees of the Department of Corrections engaged in the following improper governmental activities:***

- ☒ ***One employee received a gift from a state vendor in the form of reduced vehicle registration fees.***
  - ☒ ***Created the appearance of a conflict of interest by directing substantial state business towards a vendor who also repaired their personal vehicles.***
  - ☒ ***Circumvented controls over repairs and modifications and did not hold the vendor accountable for failed repair work.***
- 

We investigated and substantiated an allegation that vehicle maintenance officers and senior staff at the Department of Corrections' (corrections) Southern Transportation Unit (STU) had their privately owned vehicles repaired by a vendor that also repairs the STU's state vehicles, and that some individuals received discounts from the vendor. We also substantiated other improper activities. Specifically, we found:

### **Finding #1: One employee improperly received a gift and created the appearance of a conflict of interest.**

One employee improperly received a gift in the form of reduced registration fees when he purchased a car from a dealership whose owners also own an automotive repair shop used regularly by the STU. The employee, whose duties place him in frequent contact with such vendors and give him the ability to influence which vendors management selects, purchased a sport utility vehicle from the dealership for \$17,602. However, the purchase price reported to the Department of Motor Vehicles (DMV) was only \$10,000. Thus, the employee benefited in the form of reduced registration fees associated with the sale.

### **Finding #2: Other employee transactions created the appearance of a conflict of interest.**

Four employees, all of whom held positions that enabled them to authorize or influence the amount of state business a vendor received, created the appearance of a conflict of interest when they used one vendor to perform the majority of the STU's repairs while the same vendor also repaired their personal vehicles. One of these employees, a manager, said he instructed staff to use the vendor as the primary vendor of choice for maintenance and repairs of STU's fleet after performing his own analysis and receiving input from his vehicle maintenance



officers. However, his analysis conflicted with what the previous STU manager had found—that is, that several qualified vendors offered comparable services and prices. She decided to stop using the vendor when she noticed the vendor engaged in an apparent pattern of excessive repairs and when she became aware that several employees were taking their personal vehicles to the vendor and were allegedly receiving discounted prices. Despite her concerns, shortly after she left the STU on July 14, 1997, the STU again began using vendor A almost exclusively.

In addition, from March 1998 through March 2000, we found at least five employees used the vendor for maintenance and repairs on their personal vehicles. Although we did not find any direct evidence that all these employees received vendor discounts, certain aspects of their transactions were questionable. For instance, one document included information that appeared to indicate a manager received a \$45 discount. We also noticed on the invoice that the vendor failed to charge the manager for oil disposal fees commonly associated with the type of service provided. Such transactions, coupled with the significant increase in state business the vendor received, contributed to the appearance of conflicts of interest.

**Finding #3: The STU circumvented controls when purchasing high-cost repairs from the vendor, failed to hold the vendor accountable for failed repair work still under warranty, and paid the vendor to make modifications without obtaining the appropriate approval.**

We found at least five instances in which the State paid for repairs in excess of \$500 after the STU either encouraged or allowed the vendor to split the cost of the repairs over multiple invoices in order to circumvent the approval process. In addition, the STU did not collect for failed repair work still under warranty. For example, the STU paid \$1,300 to the vendor for replacing a computer module, ignition switch, and alternator on a state vehicle. Two weeks and less than 1,000 miles later, the vehicle experienced similar problems, yet the STU paid the vendor approximately \$632 to install another computer module. The STU also paid the vendor to make vehicle modifications without obtaining the appropriate approval. For instance, the STU used the vendor to install cruise control for \$384 and air horns for \$105 on a state vehicle without obtaining the appropriate approvals.

***Corrections' Action: Corrective action taken.***

Corrections agreed that one employee received a gift in the form of reduced vehicle registration fees, but could not develop a preponderance of evidence that the employee was responsible for misreporting the vehicle sales price. Corrections also agreed that STU employees circumvented controls over repairs by allowing invoices to be split. Corrections counseled each employee concerning the appropriateness of their actions and placed a record of the discussion in their personnel files.



# DEPARTMENT OF TRANSPORTATION

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## ***Investigations of Improper Activities by State Employees, July 2000 Through January 2001***

ALLEGATION I980141 (REPORT I2001-1), APRIL 2001

Department of Transportation's response as of November 2002

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

***A California Department of Transportation (Caltrans) employee:***

- ☒ ***Had a conflict of interest when he participated in making Caltrans decisions that benefited a company owned by his wife.***
- ☒ ***Misused his state position to influence Caltrans contractors and other private businesses to do business with his wife's company.***
- ☒ ***Used state resources to solicit work for his private consulting business.***

***Caltrans:***

- ☒ ***Did not require this employee, nor others in similar classifications, to file annual statements of economic interest to assist in identifying and preventing conflicts of interest.***
- 

**W**e investigated and substantiated that an employee of the California Department of Transportation (Caltrans) violated conflict-of-interest laws and engaged in incompatible activities. In addition, Caltrans failed to identify and prevent conflicts of interest. Specifically:

### **Finding #1: The employee participated in a governmental decision that benefited his wife's company.**

The employee, acting within the authority of his position, but contrary to state law, recommended that the erosion control product sold by his wife's company be used on a Caltrans project, resulting in state payments to her company.

### **Finding #2: The employee's actions created at least the perception of more conflicts of interest.**

At least 35 contractors, subcontractors, or vendors on Caltrans projects also purchased products from the company owned by the employee's wife. The employee's state position provided him with the opportunity to influence contract specifications and wield considerable power over a substantial number of contractors and subcontractors, creating at least the perception of more conflicts of interest.

### **Finding #3: The employee offered to use his influence to benefit other companies and potentially himself.**

The employee told a business owner that he could use his Caltrans position to make sure that a product he wanted to manufacture and sell with the owner would be specified for projects throughout the State. The employee violated the prohibition against incompatible activities by offering to use the influence of his state position in ways that would financially benefit not only contractors but possibly himself. Another

company's Web site contained a quote from the employee, who was identified as a Caltrans employee, which could be interpreted as an endorsement.

**Finding #4: Contractors believe the employee used his authority to influence and intimidate them and others.**

Contractors told us that they believed the employee had used his state position to compel, intimidate, or threaten contractors to get them to use particular materials produced by his wife's company. In addition, the employee's favoritism toward some vendors was not only discouraging for the competition but also might have resulted in Caltrans paying higher prices.

**Finding #5: The employee created confusion by representing both Caltrans and his wife's company.**

The employee represented both Caltrans and his wife's company at professional conferences, creating confusion about whose interests he was representing. The fact that the employee both works for Caltrans and represents his wife's company could be interpreted as a Caltrans endorsement, creating an unfair advantage for the company.

**Finding #6: Caltrans conducted three investigations of possible conflicts of interest involving the employee but did not take appropriate action.**

Caltrans knew the employee wrote contract specifications and tried to use his influence in other ways that benefited his wife's company. Caltrans also knew the employee solicited private consulting work on state time. Although Caltrans issued instructions for conduct to the employee, he violated the instructions and continued to use Caltrans information to his advantage by assisting his wife's company. Individuals in the erosion control industry said that Caltrans' inaction sent a clear signal that this is what passes for acceptable behavior by state employees.

**Finding #7: Caltrans has not established adequate controls over conflicts of interest.**

Caltrans did not require the employee, or other employees in similar positions of influence, to disclose their financial interests. As a result, Caltrans may be unaware of employees' financial interests that could conflict with their responsibilities as state employees.

***Caltrans' Action: Corrective action taken.***

In late 2000, the employee's supervisor warned the employee not to engage in any activity related to erosion control (the industry in which his wife's company operates) during work hours or in his capacity as a Caltrans employee. In direct violation of this warning, the employee attended a Caltrans-sponsored meeting for the erosion control industry in June 2001. In addition, only six days after the personnel board approved the stipulated agreement from the employee's previous disciplinary action, on February 21, 2001, the employee posted an inquiry on the Caltrans intranet related to erosion control.

To discipline the employee, Caltrans attempted to reduce the employee's pay by approximately 17 percent for 12 months. The employee appealed this decision to the personnel board, which modified the disciplinary action to a 5 percent salary reduction for 6 months.



# EMPLOYMENT DEVELOPMENT DEPARTMENT

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## ***Although New Telephone Services Have Enhanced Customer Access to the Department's Unemployment and Disability Insurance Programs, Customers Encounter Difficulties During Peak Calling Periods***

REPORT NUMBER 99031, JULY 2001

Employment Development Department's response as of July 2002

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

*Our review of the Employment Development Department's (department) introduction of toll-free telephone services for customers of its unemployment insurance and disability insurance programs reveals that:*

- ☒ *Its efforts have improved customer service and increased the public's access to the programs.*
  - ☒ *Customers of both programs are generally satisfied with the services.*
  - ☒ *Despite its efforts, callers may encounter busy signals, hear instructions to call back later, or endure lengthy waits if they ask to speak to a customer service representative during certain periods.*
  - ☒ *The department cannot measure whether the programs have met the goals established for desired response times to their customers.*
- 

Chapter 329, Statutes of 1998, directed the Bureau of State Audits to review the effects that the introduction of toll-free telephone services had on the Employment Development Department (department) and customers of its unemployment insurance (UI) and disability insurance (DI) programs. Our review indicates that the department's efforts have improved customer service and enhanced customer access to the programs. In addition, customers of the programs were generally satisfied with the services they received over the telephone. Despite its efforts, the department can make further improvements. Specifically, we found:

**Finding #1: During certain periods, customers of the department's UI and DI programs have experienced difficulties when requesting customer assistance. Staffing shortages and phone system failures contributed to the problems the customers encountered.**

Callers to the UI program's toll-free telephone numbers have experienced lengthy wait times during certain busy periods. For example, more than 60 percent of the UI program's callers during a peak service period in February 2001 waited on hold five or more minutes to speak to a customer service representative. In contrast, 18 percent waited on hold five or more minutes during December 2000. The department asserted that staffing shortages have contributed to its difficulties in providing prompt customer service. It attributed the shortages in part to the complexities and slowness of the civil service hiring process. Thus, the department has begun to explore alternative hiring methods to reduce the lengthy wait times.



Customers of the DI program experienced staffing shortages as well as other problems. As of April 2001 the program only had 58 percent of the authorized customer service representatives in its two call centers available to take calls. With the staffing shortages, callers may find it more difficult than usual to obtain information. For instance, over a 15-month period from January 2000 through March 2001, the telephone system at DI call centers required nearly 687,000 (27 percent) of the 2.5 million callers who asked for customer assistance to call again. Additionally, nearly 31,000 callers routed to the DI program's call centers received busy signals in the first three months of 2001 when its telephone system faced numerous breakdowns after the installation of new equipment. Only 850 callers encountered busy signals during the same period in 2000.

We recommended that the department continue to explore ways and methods within the State's civil service system to hire and retain customer service representatives. Additionally, the department should consider performing a study to examine the effect on UI call center workloads of increasing business hours for call centers during peak calling periods.

We also recommended for the DI program that the department complete customer service contingency plans and limit the effect and number of system breakdowns during installation of future system changes.

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

The department initiated continuous filing in its hiring process to ensure an ongoing pool of eligible candidates for service representatives in the UI and DI programs. Additionally, the State Personnel Board adopted changes in the minimum qualifications of the service representatives. The department also continued to hire extensively in its UI and DI field offices after it requested and received until May 2002 an exemption from a state employee hiring freeze. Despite the department's efforts, it states that service problems have not yet been resolved in the UI call centers because of its staff attrition rate, increased workload, and time to train staff. Thus, the department has redirected staff from other programs to meet its increased UI program demands. Further, the department studied the effect on UI call center workloads of extending its business hours. It found that the increased hours of operation had limited benefits. However, the

department states its implementation of Internet claim filing has had a positive effect on UI call center workloads. Thus, the department plans to continue its Internet-based UI claim filing efforts to improve access to services. For the DI program, the department saw improvements in its call center workload when it conducted a pilot program to extend business hours. As a result, the department plans to conduct a cost-benefit analysis to determine if extended business hours are feasible during certain calling periods.

To limit the effect and number of system breakdowns for the DI program, the department states it has developed contingency plans that are under review by DI program management. It has also purchased software that allows it to more easily reroute customer service calls and take corrective action when system breakdowns occur.

**Finding #2: The department cannot measure for the UI and DI programs whether it has met the goals established for its desired response times to customers.**

The department established separate response time goals for its UI call center staff to answer calls requesting information and to answer claim-filing calls. However, since 1999 one of the department's system modifications eliminated its ability to distinguish information calls from claim-filing calls. In addition, reports prepared for management do not detail how well the call centers are doing as far as meeting the goals. The department is evaluating a proposed goal that it can use to measure the response time for all UI customer calls.

The department set a goal for its DI call centers and customer service units to answer in four minutes 90 percent of all calls requesting information. However, it evaluates the program's performance from management reports that do not routinely include the customer service units, which receive 42 percent of the program's calls. Additionally, its management reports do not indicate its performance in meeting its stated goal.

We recommended the department promptly complete for the UI program its process for setting challenging yet reasonable goals for answering customer calls. The department should also modify the DI program's management reports to include the call activity at its customer service units. We further recommended that the department modify the management reports for both programs to measure their performance in meeting their goals.

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

The department states for the UI program that, although it is analyzing data to establish reasonable response time goals and modify management reports to measure performance, it has directed its efforts to hire and train more call center staff and increase access to its services. For the DI program, the department has modified its management reports to measure its performance in meeting its goal. However, the management reports do not include call activities at its customer service units. The department states that outdated equipment prevents it from capturing the data. Additionally, the department is working to establish another DI call center to handle the calls routed to the customer service units.

**Finding #3: The department should conduct planned customer satisfaction surveys of certain UI and DI program customers.**

We found that the department has begun only recently to conduct surveys of specific UI customer groups, such as Cantonese- and Vietnamese-speaking customers or teletypewriter users. Prior surveys performed by the department were unlikely to get representation from these groups because their populations are relatively small.

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

The department completed for the UI program its pilot surveys of teletypewriter users and customers speaking Cantonese and Vietnamese. The department now includes these customers when it conducts its annual survey to obtain feedback on UI services received. Further, the department conducted a survey of DI program customers and reported its results in December 2001. It conducted another survey of DI customers in March 2002 and plans to report the results by July 31, 2002.

# DEPARTMENT OF INDUSTRIAL RELATIONS

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

REPORT NUMBER 2001-017, SEPTEMBER 2002

Department of Industrial Relations' response as of December 2002

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

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

- ☒ *The department's process for verifying the status of farm labor contractors' licenses has been operational since July 1, 2002.*
  - ☒ *Agricultural growers, farm labor contractors, and others can request license verifications through the department's Web site or by electronic mail, telephone, or facsimile.*
  - ☒ *More oversight is needed of the department's license verification process, especially in these early stages of implementation.*
- 

Chapter 157, Statutes of 2001, amended Section 1695.7(e) of the Labor Code, and required the labor commissioner in the Department of Industrial Relations (department) to establish a unit for verifying the status of farm labor contractors' licenses by July 1, 2002. According to the amended code, agricultural growers and farm labor contractors that subcontract work must verify that a farm labor contractor is properly licensed. The Bureau of State Audits was required to certify that the department's unit responsible for these verifications is operational. Based on our review, we found the following:

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

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

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

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

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



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



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

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

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

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

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

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

The department reports that the number of faxed license verification requests has fallen from 91 in the first month of operation to less than 20 per month. Therefore, the department does not believe it is necessary to have a fax machine dedicated to license verification requests.

Additionally, the department reports that it received 83 license verification requests over the telephone in the first month but now receives less than 40 per month. The department does not believe that it is necessary to install a telephone line dedicated to this function.

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

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

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

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

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



# LOS ANGELES COUNTY METROPOLITAN TRANSPORTATION AUTHORITY

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## ***It Can Increase Its Efforts to Ensure the Safe Operation of Its Buses***

REPORT NUMBER 2001-101, AUGUST 2001

Los Angeles County Metropolitan Transportation Authority's  
response as of November 2002

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

*Our review of the Los Angeles  
County Metropolitan  
Transportation Authority's  
management and monitoring  
of its bus operations revealed  
that it:*

- ☒ *Lacks an effective system  
to prevent all violations of  
driving time restrictions.*
  - ☒ *Does not adequately track  
the time its bus drivers  
work for other employers.*
  - ☒ *Has an error-prone  
accident database that  
makes analysis difficult  
if not impossible.*
  - ☒ *Does not take full  
advantage of information  
on traffic citations to  
consistently discipline its  
bus drivers.*
- 

The Joint Legislative Audit Committee requested that we examine the Los Angeles County Metropolitan Transportation Authority's (MTA) management and monitoring of its bus and rail operators. Specifically, we were asked to determine if the MTA complies with applicable federal and state laws designed to protect driver and public safety. We were also asked to review the MTA's procedures for monitoring the secondary employment of its part-time drivers. We found that:

### **Finding #1: The MTA lacks an adequate system to prevent violations of driving and on-duty time restrictions.**

Although state law requires it to ensure that its bus drivers do not exceed established maximum driving and on-duty time limits, the MTA does not generate sufficient information either to be aware of or to prevent all such violations. Federal and state laws dictate bus drivers must not drive more than 10 hours, or for any period after having been on duty 15 hours, and both of these restrictions require a prior off-duty period of at least 8 hours. The MTA's scheduling database generates reports on drivers who work more than 12 hours to ensure that they complete driver logs, but it does not report on the actual driving time. Moreover, because no reports are generated on drivers who work less than 12 hours but drive more than 10, the MTA has no information on those possible violations. Also, the MTA's report on drivers who work more than 15 hours contains numerous errors and thus may not identify time violations. Finally, the MTA cannot use any of the reports, which are generated after the fact, to prevent violations.



The MTA should take the following actions:

- Continue upgrading its Transit Operating Trends System (TOTS) database. In addition, it should further enhance TOTS so it can produce reports that identify all bus drivers who have driven more than 10 hours or for any period after having been on duty for 15 hours.



***MTA Action: Pending.***

The MTA plans to complete the TOTS upgrade, but has not established a completion date. In addition, the MTA states that it is not technologically feasible at this time to enhance TOTS so it can produce reports that identify all bus drivers who have driven more than 10 hours or for any period after having been on duty for 15 hours. Nevertheless, it will monitor advances in technology and the development of its Advanced Management Transportation System, a bus scheduling system, to seek opportunities for applying this feature.

- Ensure that its division managers review, correct, and re-run the 15-hour report daily so that the report contains accurate information.

***MTA Action: Corrective action taken.***

The MTA states that division staff update the 15-hour report daily.

**Finding #2: The MTA does not effectively track secondary employment.**

An important step in preventing bus drivers from exceeding the maximum legal on-duty hours is identifying whether they have employment outside of the MTA (secondary employment), and if so, the types of duties and the number of hours spent with those employers. However, the MTA lacks a database for tracking the secondary employment of its bus drivers, and thus is unaware of drivers who exceed the maximum legal on-duty hours and may cause accidents.

The MTA should take the following actions:

- Enforce its newly established procedures by requiring all divisions to provide, and all bus drivers to complete, secondary employment disclosure letters. These letters should be updated periodically throughout the year.

- Consistently ask for hours worked per week, phone numbers, addresses, and job duty information on the secondary employment disclosure letters. Also, division staff should periodically select a sample of bus drivers and call their other employers to verify the bus drivers' time commitment.
- Develop a database to track those bus drivers who have secondary employment and must submit a daily driver log.



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

The MTA began using a revised secondary employment form for its drivers to complete in early December 2001 and reports that it requires its drivers to fill out the form every six months. The form requests certain information about the drivers other employment such as the company's name, address, and phone number. It also includes the number of hours worked per week by the driver. However, the MTA has not yet developed a database to track those bus drivers who have secondary employment but intends to do so in 2003.

**Finding #3: The MTA's system for tracking bus driver accidents has flawed data.**

In addition to not always knowing when drivers violate on-duty restrictions, the MTA cannot be sure how long drivers have been working at the time they have accidents. Although the MTA tracks the number of bus driver accidents using a database, the Vehicle Accident Monitoring System (VAMS), we found numerous errors in VAMS. Some bus drivers improperly documented the amount of time that elapsed between when they started work and when accidents occurred. In addition, some data entry staff in MTA's bus division did not properly input details from the accident report into the VAMS. As a result, VAMS is not useful to the MTA for analysis that might determine potential causes of bus accidents. In particular, the unreliable data make it impossible to determine whether driver fatigue has contributed to accidents.

To ensure that it captures more accurate accident data, we recommended that the MTA provide refresher training to its bus drivers and data entry staff on how to fill out accident reports and how to enter information into VAMS. Further, it should complete its plans to include controls that ensure drivers' data is coded correctly in VAMS.

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

The MTA hired a safety management consultant to develop a safety improvement workplan and has implemented the plan throughout its organization. The MTA's plans for completing the TOTS upgrade by June 2002 have been postponed until it hires a new contractor to complete the work. However, the MTA has purchased a software package that will become the principal data entry portal for all injury and incident reporting, including vehicle collisions. The MTA plans to link this system to VAMS.

**Finding #4: The MTA does not take full advantage of information on drivers' traffic citations to consistently apply its discipline process.**

State law requires the MTA to participate in a Department of Motor Vehicles (Motor Vehicles) process that gives motor carriers full disclosure, including citations, of any action against a bus drivers' driving record. However, the MTA does not take full advantage of this Motor Vehicles information. Moreover, our sample of driver citations reveals that bus drivers frequently fail to disclose their citations to division managers, despite the MTA's policy requiring them to do so. For example, we were unable to find any evidence that bus division managers were aware of citations for 39 of the 56 bus drivers in our sample. Being unaware of all citations, managers cannot equitably use the discipline process to identify and, if necessary, discharge bus drivers.

The MTA should periodically distribute Motor Vehicles' summary citation data to its division managers so they can readily access all citations relating to all their bus drivers.

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

The MTA has created a reporting system whereby division managers receive monthly summary citation reports. The division managers report that these monthly reports are valuable and are being used to identify on- and off-duty issues. The MTA is continuing to address its ability to design and construct a database that can capture the actions taken by the division managers for the issues they identify.

# WATER REPLENISHMENT DISTRICT OF SOUTHERN CALIFORNIA

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

REPORT NUMBER 2000-016, MAY 2002

Water Replenishment District of Southern California's  
response as of November 2002

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

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

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

*continued on next page*

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

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

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

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

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

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

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

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

#### ***District Action: Pending.***

The district states that it will make a recommendation to its board of directors (board) and the board will adopt a new reserve policy prior to adopting the fiscal year 2003–04 budget. That policy will be the basis for seeking legislative approval of statutory changes to the water code in the next

legislative session. In addition, the district states that district staff are currently working on a plan to establish optimum and minimum water quantities for stored groundwater.

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

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

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

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

The district cannot immediately recover financially from its past decisions. Currently, the water code limits the district to raising its rate by the local consumer price index (CPI) plus 1 percent, with a maximum 5 percent increase above the previous year's assessment. However, the CPI may not be the most appropriate index by which to restrict assessment rate increases since it is reflective of consumer inflation, not necessarily of increases to

the district in its cost of water purchases. This limitation is set to expire on December 31, 2002, although the Legislature may choose to extend that restriction.

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

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

***District Action: Pending.***

The district states that it will determine the assessment rate that is required to maintain an adequate reserve balance.

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

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



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

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

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

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

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



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

The district states that its controller has already issued preliminary policies and procedures and assumed responsibility for maintaining a central budget file. The controller is also responsible for the continued implementation of written policies and procedures over budget preparations. By the end of March 2003 the controller will finalize and distribute these policies to staff.

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

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

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

- Assess all activities it performs and their priority to the district's role versus the activities and roles of other water agencies in the region.

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

***District Action: Pending.***

The district reports that it is in the process of updating its strategic plan and has held three public workshops to solicit stakeholder input into the strategic planning process. The district states it has developed a draft capital improvement plan, including projects and programs that are clearly identified as new or ongoing. The district anticipates the plans will be ready for board adoption by mid-2003. In addition, the district will develop a policy for periodically updating strategic and capital improvement plans.

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

Assembly Bill 1163 was enacted in September 2002 to require the district to develop and update a 5-year capital improvement program using input from a technical advisory committee made of water professionals appointed by the Central Basin Water Association and the West Basin Water Association (technical advisory committee).

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

Despite the fact that over the past two fiscal years it has spent \$19.9 million on capital improvements, the district lacks a standard process for identifying and resolving the risks attached to potential projects and for evaluating the projects' costs and benefits. As a result, the costs of some projects are likely to exceed the district's estimates, and it may not gain the benefits it expected. For instance, the district invested \$10.3 million in the Goldsworthy Desalter facility (desalter) to remove saltwater contamination from the West Coast Basin without seeking clarification as to whether it would need legal rights to pump the saltwater from the basin. When the district sought this

clarification, the court determined the level of salinity of the extracted water necessary to exempt the district from obtaining legal pumping rights to be higher than the district had planned when it built the desalter. If the water pumped by the district does not reach that level of salinity, the district's operating costs will increase or it may have to invest up to an additional \$2.3 million to qualify the desalter for a subsidy of its operating costs.

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

In our December 1999 audit report, we recommended that the district standardize its process for preparing cost-benefit analyses for the capital improvement projects it considers for development. However, the district has not yet implemented such a policy. In a cost-benefit analysis, the district should define and evaluate the costs and perceived benefits of a proposed project and alternative projects, thus allowing it to make reasonable, informed decisions and to choose between different strategies. Further, the district should follow a consistent approach in preparing its analyses in order to avoid skewing the results in favor of projects it wants to do. Although the district states that it regularly conducts financial evaluations of its capital improvement projects, it does not have documented procedures for its staff to follow in performing cost-benefit analyses. The lack of a standard policy may result in inconsistent or poor analyses, which in turn may cause the district to forgo beneficial projects or spend its limited funds on less-desirable alternatives.

The district should establish a standardized approach to evaluating and selecting capital improvement projects. At a minimum, the approach should include the appropriate steps to identify legal, technical, and financial risks of proposed projects. Also, the district should implement a cost-benefit analysis methodology that (1) defines standards and

assumptions to use when evaluating replenishment projects and (2) offers a process for weighing alternative solutions to contaminant mitigation issues.

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

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

The district states that after it has completed updating its strategic plan, and in cooperation with the technical advisory committee, it will develop a standardized approach to identify the legal, technical, and financial risks of proposed capital projects. Once the cost and benefits of proposed projects are identified, the district will seek recommendations from the technical advisory committee and board approval to move forward with a particular project. In addition, the district reported that it had received from the court an extension of time for its desalter to reach the chloride levels required in the operating criteria. In November 2002, the desalter reached those levels and the district is preparing the reports to substantiate its compliance to the court. Finally, the district and the county have finalized the resolution to the issue related to the Los Alamitos Barrier project.

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

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

Also, the district's current contracts with three legislative advocacy firms and three law firms do not specify the duration of the agreements. The district entered into most of these

contracts between 1998 and 2000, although one dates to 1989. For the six firms combined, the district paid more than \$1.4 million in 2001. Although the district correctly points out that it signed the contracts prior to the current requirement that all contracts contain duration, we believe the current requirement reflects sound business practice for all contracts.

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

In spite of the lingering weaknesses in the district's management of its contracts, some provisions imposed by the water code and the district's Administrative Code (district code) appear too restrictive. In response to our December 1999 audit report, one requirement the Legislature placed on the district's contracting practices requires that the board president and secretary sign all contracts and other documents that the district enters into. Although this requirement allows the district's board complete oversight of contracting practices, it has the potential of being administratively burdensome for contracts below certain dollar thresholds. Similarly, the district enhanced the contracting provisions in its policies by adopting certain portions of the California Public Contract Code into the district code. However, one of the provisions in the district code places burdensome restrictions on the district's contracting practices by requiring a formal written process for requesting proposals for most contracts and requires board approval of all contract solicitations for professional services, regardless of dollar amount.

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

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

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

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

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

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

The district states that it is taking steps to strengthen its contract management policies and procedures, including assigning management staff to serve as contract managers, reviewing current contracts to ensure they comply with applicable legislative mandates, and implementing annual quality reviews of services before renewing any contracts. In addition, the district intends to seek legislation amending the water code to allow the board to delegate the approval and signing of contracts below certain dollar thresholds to the district's general manager.

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

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

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

In addition, the district has not adequately controlled reimbursements to managers, directors, and consultants for travel and meal expenses. The district’s policy states that employees can be reimbursed for travel and meal expenses, within defined dollar limits, only outside a defined local area, and requests for expense reimbursement must be submitted within 90 days. However, we found that the district reimbursed its interim general manager \$915 for local meals purchased over a nine-month period, reimbursed one director for meal expenses in excess of the established limits, and reimbursed consultants nearly \$3,000 without obtaining the business purpose of the expenses.

We recommended that to better control its administrative costs, the district should continue its development and implementation of written accounting procedures. It should ensure that these procedures require that only authorized staff approve purchases of goods and services and approve payments

to vendors or consultants, and staff maintain documents that demonstrate efforts to ensure that the district receives value for purchases that do not require formal bidding.

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

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

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

The district reports that its controller is responsible for the continued development and implementation of written accounting procedures. The controller has issued preliminary policies and procedures and distributed them to staff and will finalize and distribute additional policies and procedures in the near future. Those policies and procedures include requirements for reimbursement of travel or conference costs for district staff, board members, and district contractors.

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

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

In addition, the district code is silent on the board's position as to which types of expenditures promote the district's public purpose. During 2001 the district spent more than \$500 for flowers for employees, directors, and nonemployees; it also spent almost \$3,500 for its annual holiday party. However, we did not find a district policy that establishes a reasonable basis for its position that these expenses support the district's public purpose, and as a result, we believe that these payments are gratuities and thus a gift of public funds. The district also paid \$2,000 to co-sponsor a dinner at the National League of



Cities annual conference in Boston, Massachusetts. The district justified the cost by stating that many Los Angeles-area cities had representatives at the event, but otherwise it could not demonstrate how the expense furthered its public purpose, nor could it provide evidence that the board considered the necessity and reasonableness of the expense before approving it.

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

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

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

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

The district states that it will further amend its district code to ensure consistency with relevant state water code provisions. In particular, the district will work to update its code to provide clear guidelines on allowable expenses and define appropriate reimbursable lodging expenses.

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

Amendments to the water code require that, effective January 1, 2001, the district present estimates of the costs to complete and the funding sources for its capital improvement

projects in its annual audited financial statements and that it also include a report from its independent auditor evaluating the propriety of its operating expenses. However, the district included an incorrect list of capital improvement projects in its audited financial statements and overstated their estimated costs by \$3.6 million. In addition, the district did not include the required report on the propriety of its operating expenses.

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

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

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

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



# DEPARTMENT OF CORRECTIONS

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## ***A Shortage of Correctional Officers, Along With Costly Labor Agreement Provisions, Raises Both Fiscal and Safety Concerns and Limits Management's Control***

REPORT NUMBER 2002-101, JULY 2002

Department of Correction's response as of September 2002

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

*Our review of the California Department of Corrections' (department) ongoing fiscal problems revealed:*

- ☒ *A shortage of correctional officers continues to drive overtime costs higher.*
  - ☒ *At its current pace of hiring, it may take the department until 2009 to meet its need for additional correctional officers.*
  - ☒ *Some officers work excessive amounts of overtime while others at the same prison work very little overtime.*
  - ☒ *Certain provisions in the labor agreement between the State and the California Correctional Peace Officers Association, related primarily to correctional officers, will eventually add about \$518 million to the department's annual costs.*
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The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct an audit of various Department of Corrections' (department) fiscal problems. The audit committee expressed particular interest in the collective bargaining process that governs the department's relationship with its correctional officers, the assignment of new cadets from the academy to prisons, the impact of statewide mandated salary savings on correctional officers' use of overtime and sick leave, and the impact of medical transportation costs on the cost of medical care.

### **Finding #1: The department pays large overtime costs to cover for unmet correctional officer need.**

The department has been unable to attract and train enough correctional officers to meet its needs. Specifically, as of September 2001, its full-time and intermittent officers numbered only 19,910 while its budget and labor agreement allow for a maximum of 23,160 officers. As a result, the department has an unmet need of about 3,250 officers. To fill this unmet need, the department has resorted to assigning overtime. During the first half of fiscal year 2001–02, the department spent more than \$110 million on custody staff overtime—already \$36 million more than its overtime budget of \$74 million for the entire fiscal year. We estimate that the department will not fill its unmet officer need until sometime between the end of 2005 and the beginning of 2009, depending on the number of future academy graduates and the officer attrition rate.

To reduce its use of overtime, the department should consider the feasibility of further increasing the number of correctional officer applicants and, if warranted, the physical capacity

for training them. Additionally, the department should pursue additional funding from the Legislature to operate its academy at full capacity. Once it can attract more cadets to its academy, the department should pursue funding for additional correctional officer positions that it will need to reduce its reliance on overtime. Until such time, as the department has enough correctional officers to meet its needs and incurs only unavoidable overtime, the department should be realistic in its budget and plan for the overtime it will need to cover its unmet need. Finally, the department should maximize its use of intermittent officers by either converting them to full-time or ensuring that they work as close to the 2,000-hour-a-year maximum as possible.

***Department Action: Pending.***

The department states that it has completed an analysis identifying its correctional officer staffing needs through June 2005, and has prepared a proposal for consideration as part of its fiscal year 2003–04 budget. It also states that its academy is currently running at full physical capacity and that it has staggered academy commencement dates to ensure that all available academy bed space is utilized. The department told us that it is pursuing authority and funding for additional correctional officer positions, and indicated that the use of sick leave by correctional officers since the new labor agreement became effective on February 19, 2002, has increased. Therefore, it will also seek funding and additional relief positions commensurate with the increased sick leave usage. In addition, the department stated that as part of its analysis of correctional officer needs through June 2005, it has developed procedures to project the overtime necessary to cover vacancies, and has incorporated this information into its fiscal year 2003–04 budget request. Further, the department indicated that its institutions maximize their use of intermittent officers by converting them to full-time when positions become vacant and if, or when, intermittent officers are eligible for and accept permanent positions. Finally, the department reported that many of its institutions are scheduling intermittent officers to specific shifts.

**Finding #2: Savings from vacant budgeted positions are insufficient to finance shortfalls in the overall funding for correctional officers and overtime.**

The savings the department realizes by intentionally leaving more than 1,000 of its authorized correctional officer positions vacant under the Institutional Vacancy Plan do not result in net salary savings because the budget for each officer is not sufficient to meet the actual costs when an officer works full time. Specifically, we estimated that the department would experience a net deficit of about \$193 million related to its funding of correctional officers and overtime in fiscal year 2001–02.

To reduce its use of overtime, the department should fill vacant relief officer positions currently in its Institutional Vacancy Plan once it has filled its positions currently vacant because of insufficient staff.

***Department Action: Pending.***

The department states it is making every effort to fill vacant positions. The department reports that it has reduced its vacant permanent full-time positions to 794 as of July 31, 2002, compared to 1,040 at June 30, 2002. It also adds that 638 additional cadets were scheduled to graduate in October 2002, of which 147 were permanent full-time officers and 491 were permanent intermittent. Finally, the department notes that as required in the current bargaining agreement, it plans to activate 400 relief positions previously included in the Institutional Vacancy Plan between fiscal years 2001–02 and 2003–04.

**Finding #3: A more strategic assignment of new cadets and better monitoring of overtime worked at each prison would be beneficial.**

The department does not consider the varying amounts of overtime that correctional officers work at its prisons when assigning cadets from its academy. In particular, based on our review of the November 2001 academy, we found that there was no strong correlation between the assignments of new cadets and the amount of overtime at each prison. In addition, we found that a total of 235 officers at 26 different prisons averaged more than 80 hours of overtime each work period between July and December 2001. The department could also better protect

the health and safety of everyone in the prison setting by more evenly distributing the total overtime among individual officers within each prison.

To reduce health and safety risks for its employees, the department should reassess the number of budgeted full-time positions at each prison and determine whether reallocations are warranted because of excessive overtime at specific prisons. Additionally, the department should pursue options to limit overtime that individuals work so that individuals do not exceed the 80-hour cap considered relevant for health and safety risks.

To better match the supply of correctional officers with the demand for correctional officers that use of overtime hours indicates, the department should consider assigning its academy graduates to those prisons that experience the highest levels of overtime. For example, if it has too many qualified candidates to fill a class, the department could give preference to candidates willing to go to the 10 prisons with the most overtime.

***Department Action: Pending.***

The department states that virtually all institutions are operating in a deficit with regard to overtime, and consequently it believes that reallocation of budgeted positions to reduce overtime is not feasible at this time. In addition, the department states that it is making a concerted effort to fill all vacant officer positions to reduce the number of officers working 80 hours of overtime per month. However, the department notes that the number of correctional officers averaging more than 80 hours of overtime has increased from the 235 we reported for July through December 2001, adding that 260 correctional officers averaged more than 80 hours of overtime between January and July 2002. Further, the department states that until the pool of candidates on its correctional officer certification list increases significantly, competition is inadequate to make high vacancy institutions attractive to correctional officer candidates. Nevertheless, its academy will continue efforts to increase the pool of candidates willing to work at high vacancy institutions.

**Finding #4: Certain provisions of the new labor agreement increase the department's fiscal burden and limit management's control.**

The new labor agreement between the State and the California Correctional Peace Officers Association includes many provisions that either increase personnel costs or create challenges for the department to effectively manage its staff. Ranging from salary increases and enhanced retirement benefits to seniority-based overtime, some of these provisions were included in the prior labor agreement, but many are new to the labor agreement that was ratified in February 2002. The department estimates that the annual cost of new provisions in the agreement will be as high as \$300 million a year by fiscal year 2005–06, the latest year for which it has estimated costs. In developing these estimates, the department included classes of employees who are covered by the agreement, such as medical technical assistants and correctional counselors, as well as correctional officers. Focusing mainly on costs related to correctional officers and including the entire term of the labor agreement, we analyzed five new and three continuing provisions of the labor agreement and estimate that the department's annual costs for these provisions will eventually amount to about \$518 million. Further, several changes in the provisions related to sick leave have likely resulted in additional overtime to cover for the increased use of sick leave. Finally, a continuing provision related to how post assignments are made limits the department's ability to assign particular individuals to posts of its choosing.





# OFFICE OF EMERGENCY SERVICES

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

### **ALLEGATION I2000-607 (REPORT I2002-2), NOVEMBER 2002**

**Office of Emergency Services' response as of September 2002<sup>1</sup>**

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

***The Governor's Office of Emergency Services engaged in the following improper governmental activities:***

- ☒ ***Allowed an employee (employee A) to continue to be paid for his commute time.***
  - ☒ ***Entered into an agreement with employee A's bargaining unit that the Department of Personnel Administration determined was invalid.***
  - ☒ ***Failed to follow its own administrative controls concerning overtime.***
- 

In April 2000 we reported, among other things, that poor supervision and inadequate administrative controls in the fire and rescue branch of the Governor's Office of Emergency Services (OES) had enabled employees to commit various improprieties, including claiming excessive overtime and travel costs.<sup>2</sup> Subsequently, we received information that one employee (employee A) continued to claim excessive amounts of overtime. We investigated and substantiated this and other improprieties.

#### **Finding #1: Despite prior knowledge, OES continued to pay employee A for his commute.**

State policy prohibits state agencies from paying employees for time spent commuting from their home to the work site. Even though OES became aware that this was occurring as early as November 1998, it continued to allow employee A to claim his commute time, which contributed, in part, to the extraordinary amount of overtime he subsequently received. Specifically, during the fiscal year July 1, 1999, through June 30, 2000, employee A received approximately \$100,207 in wages, of which \$35,743, or 36 percent, was overtime pay. For the next fiscal year, July 1, 2000, through June 30, 2001, he was paid approximately \$107,137, of which \$40,523, or 38 percent, was overtime.

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

<sup>2</sup> When we notified the director of OES in 2000 that we would be investigating the allegations made at that time, he informed us the CHP had begun a similar investigation at OES's request. To avoid duplicating investigative efforts, we met and coordinated with the CHP. We reported these improprieties in investigative report I2000-1.

Although much of employee A's overtime related to emergency events, nearly half was associated with nonemergency activities such as meetings or training classes. For example, of 815 hours of overtime employee A claimed in fiscal year 1999–2000, 370 hours, or approximately 45 percent, was for nonemergency events. In fiscal year 2000–01, he claimed 862 hours of overtime, of which 390 hours, or about 45 percent, pertained to nonemergency activities.

**Finding #2: Employee A may not have been told to stop claiming his commute time.**

Employee A and his managers have provided conflicting information regarding whether he was told to stop claiming his commute time. In July 1999, as our prior investigation drew to a close, we spoke with the former manager of the fire and rescue branch about the matter.<sup>3</sup> He told us that it was his understanding that employee A had been told that he no longer could claim his commute time and that he had stopped doing so. During our current investigation, employee A told us that it had always been his understanding that his home was his designated headquarters and, as a result, he claimed the time it took him to drive from his home to locations within his assigned work area. He added that to compensate for this, he sometimes did not claim all the time he spent conducting state business, such as when he worked late or responded to e-mail messages or pages on his days off. It is unclear to us why, if employee A believed this arrangement was appropriate, he felt he needed to compensate in some way for charging commute time as work hours. Regardless, we found no written evidence that OES instructed the employee that he no longer could claim his commute.

Employee A not only continued to claim his commute time, but it appears that OES never intended to prevent him from claiming this time unless it could reassign him to a work area closer to his home. In a letter dated April 7, 1999, the former manager thanked the chief of a fire district located within employee A's work area for offering OES the ability to locate one of its employees, employee A, at the fire district's headquarters. However, the former manager added, "We have reevaluated our situation and do not currently plan to relocate [employee A's] office from his current home office at this time." OES allowed the abuse to continue by declining the offer to move the employee's office from his home to a more central location within his assigned work area.

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<sup>3</sup> This manager retired from OES effective March 30, 2001.

**Finding #3: OES entered into a questionable agreement with employee A's bargaining unit.**

On April 7, 1999, the same day OES formally rejected the chance to relocate employee A's office to a location within his assigned work area, OES entered into a questionable agreement with employee A's bargaining unit. Further, not only did OES enter into this questionable agreement with employee A's bargaining unit—an agreement that the current manager of the fire and rescue branch believes permitted the employee to continue to claim his commute—but it also did not provide the Department of Personnel Administration (DPA) an opportunity to review and approve the agreement as required. When we asked the appropriate DPA official to review the agreement, he questioned its appropriateness and said he considered it invalid.

**Finding #4: The Fire and Rescue Branch still does not adhere to administrative controls concerning overtime.**

Because the Fire and Rescue Branch (branch) failed to follow its own administrative controls concerning overtime, employees have continued to incur nonemergency overtime that lacked advance authorization. In an attempt to address the past failure of the branch to control excessive nonemergency overtime and related expenses, OES reported to us on February 10, 1999, that it had implemented an administrative system that required employees in the branch to submit in a timely manner various documents that included but were not limited to a monthly calendar of planned activities, overtime authorization and claim forms, authorization for on-call hours, and absence and time reports. OES reported that supervisors would compare each document with previously approved authorizations and individual planning documents to ensure agreement and to continuously monitor overtime use and travel expenses. However, one supervisor responsible for performing these control functions admitted that some employees under his supervision had not submitted the appropriate documents by the third working day of each month, as required. As a result, the supervisor said that there might have been instances when he was not able to review and approve planned overtime and travel incurred by employees under his supervision.

Although we did not perform an extensive review of the records of each employee in the branch, we did note several instances in which employees did not receive advance approval of nonemergency overtime. For instance, during July 1999, employee A claimed 84.5 hours of overtime, 73 of which related

to nonemergency events. However, none of the documents we obtained from the branch show that employee A received prior approval for the nonemergency overtime he claimed. In June 2000, of 99.5 hours of overtime claimed by employee A, 60.5 hours were nonemergency overtime. Again, the documents we obtained did not show that employee A obtained prior authorization to work the overtime. In June 2001, another employee, employee B, claimed 43.75 hours of overtime, all for nonemergency events. Yet none of the documents we reviewed indicated that he had received prior approval for the overtime. Given that employee A and the rest of the branch historically have incurred significant amounts of nonemergency overtime, we believe it would be prudent for OES to follow its own administrative procedures designed to monitor and control overtime and travel costs.<sup>4</sup>

***OES Action: Corrective action taken.***

OES reported that the unresolved supervisory and administrative issues associated with the branch were a result of miscommunications during changes to branch management or inadequate training, but that these issues have now been addressed. Employee A has been reassigned to a work area where he lives. OES also reported that it has established administrative controls concerning overtime authorization and that it has counseled all branch employees that nonemergency overtime will not be incurred without prior authorization.

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<sup>4</sup> We previously reported that only 41 percent of overtime claimed by employees at the branch from November 1996 through June 1997 related directly to emergency conditions.

# DEPARTMENT OF MOTOR VEHICLES

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## ***Although Unable to Measure the Extent of Identity Fraud and the Effect of Recent Reforms, It Should Improve Its Technology, Procedures, and Staffing Further***

REPORT NUMBER 2001-103, SEPTEMBER 2001

Department of Motor Vehicles' response as of September 2002

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

*Our review of the Department of Motor Vehicles (Motor Vehicles) to determine whether it has adequate procedures and resources to detect or prevent the issuance of fraudulent documents revealed that:*

- ☒ ***Motor Vehicles lacks the technology to use the computer-mapped finger images it collects to verify the identity of all applicants for driver licenses and ID cards.***
- ☒ ***Motor Vehicles cannot accurately quantify the effect of new procedures aimed at detecting or reducing fraud.***
- ☒ ***Motor Vehicles can implement further procedures such as requiring two employees to verify photos it retrieves for existing customers obtaining a temporary license, driver license, or ID card.***

*continued on next page*

By issuing driver licenses and identification cards (ID cards)—California's basic identification documents—the Department of Motor Vehicles (Motor Vehicles) enables residents to establish who they are for the purposes of driving, getting jobs, and making basic financial transactions such as purchasing goods and opening lines of credit. In fiscal year 2000–01, Motor Vehicles issued about 8 million driver licenses and ID cards, with an unknown number of them going to people who managed to outwit the issuing system and obtain fraudulent driver licenses or ID cards by taking over someone else's personal information and “becoming” that person.

At the request of the Joint Legislative Audit Committee, we reviewed the procedures Motor Vehicles uses to issue driver licenses and its resources to determine whether they are adequate to detect or prevent the issuance of fraudulent documents. We also reviewed Motor Vehicles' process for issuing ID cards, because the procedures are similar to those used to issue driver licenses. Based on our review, we found the following:

### **Finding #1: Motor Vehicles cannot use existing computer-mapped finger images to verify customer identity.**

Although Motor Vehicles uses finger images to investigate potentially fraudulent applications, it cannot use them to verify the identity of all customers applying for driver licenses or ID cards because of inadequate technology, questionable image quality, and privacy concerns from opponents of finger imaging.

Because it lacks the necessary technology, Motor Vehicles cannot ensure that a customer applying for a renewal or duplicate driver license or ID card is the true holder by conducting a one-to-one

- ☑ *Motor Vehicles can better help employees prevent fraud by standardizing its fraudulent document detection training course.*
  - ☑ *Motor Vehicles' Investigations and Audits Division, responsible for investigating fraud, lacks adequate policies, procedures, and resources.*
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search, which would compare a finger image in its database against the image the customer is providing in person. Technology limitations also prevent Motor Vehicles from making sure that a new customer does not already hold a driver license or ID card under another name by using a one-to-many search, which would compare a new or existing finger image with all other images in the database. Additionally, although the finger images in Motor Vehicles' existing database date back to early 1990, Motor Vehicles was not able to collect finger images that meet Federal Bureau of Investigation standards until 1999. Furthermore, after three unsuccessful attempts at capturing an acceptable image, field representatives can force the software to accept the image and record the last print taken, which may or may not be readable. Therefore, the finger images that Motor Vehicles has taken may not support computerized searches even if it does receive the funding to upgrade its technology. Finally, some opponents of the use of finger imaging have raised both legal and policy concerns about the potential for this technology to interfere with individual privacy rights. However, with appropriate limitations on their use, finger images can be a legal and effective way to reduce identity fraud that can harm the public.

We recommended that the Legislature should reconsider funding to support an upgrade of Motor Vehicles' finger-imaging technology if recent reforms to the process for issuing driver licenses and ID cards prove insufficient. If it provides the funds, the Legislature should consider protecting against unauthorized dissemination of finger images by allowing only those entities it believes have a legitimate interest in protecting the public, such as state and local law enforcement agencies, to access Motor Vehicles' finger-imaging data. The Legislature should also consider imposing criminal sanctions for unauthorized use of the data. Further, if the Legislature approves the use of finger imaging, it should consider directing Motor Vehicles to establish controls that protect the privacy of California citizens.

Finally, Motor Vehicles should train its field representatives to capture good-quality finger images and prohibit them from bypassing system requirements for obtaining readable customer images without prior approval from their managers.

***Legislative Action: Unknown.***

We are unaware of any legislative action implementing these recommendations.

***Motor Vehicles' Action: Corrective action taken.***

Motor Vehicles reports that training on thumbprint image capturing techniques was completed in all field offices that provide driver license services. On an ongoing basis, any employee assigned responsibility for capturing thumbprint images will be required to receive this training.

Based on a pilot survey conducted at two of its field offices, Motor Vehicles concluded that supervisor approval during the imaging process does not improve thumbprint quality. However, Motor Vehicles reports that it is continuing its efforts to improve the quality of thumbprint images captured by field technicians. For example, programming changes to the imaging software are being tested that will show a "cross-hair" as a guide for field technicians to use to properly align thumbprints. Motor Vehicles expects to release this new program in early 2003. Motor Vehicles stated that it has also distributed posters to its field offices to place at the thumbprint capture workstations that show the customer the proper hand position for obtaining a readable image.

**Finding #2: Its recent reforms should reduce fraud, but Motor Vehicles cannot measure their impact.**

Between October 14, 2000, and January 2, 2001, Motor Vehicles implemented reforms to prevent the issuance of fraudulent driver licenses and ID cards. Motor Vehicles began verifying Social Security numbers with the federal Social Security Administration, retrieving renewal customers' most recent photographs from its database, and requiring two employees to verify birth-date and legal-presence documents that customers present to obtain original licenses. However, Motor Vehicles cannot accurately quantify the effect of its new procedures for three reasons. First, Motor Vehicles has inadequate methods of tracking potential fraud. Second, changes in the way Motor Vehicles categorizes and investigates fraud make it difficult to compare the number of potential fraud cases identified before and after the new procedures were in place. Third, the effect reforms have on preventing attempts to obtain fraudulent driver licenses or ID cards is impossible to measure.

Motor Vehicles should establish mechanisms to measure the effectiveness of its recent and future reforms because until it does there is no way of knowing how successful its recent reforms have been in reducing identity fraud.



***Motor Vehicles' Action: Partial corrective action taken.***

Motor Vehicles identified six performance measures for quantifying the effectiveness of its fraud reforms. It also developed a database that will be used to track workload volumes relating to these performance measures. Additionally, the Human Resources and Special Investigations branches will track data on employee fraud.

**Finding #3: Despite promising reforms, more improvements are needed to reduce fraud.**

Although Motor Vehicles has taken significant action to reduce the possibility of issuing fraudulent driver licenses and ID cards, some reforms could be expanded. For example, photo retrieval to identify a prior customer would be a stronger reform if a second employee confirmed the original field representative's verification that the customer matched the retrieved photograph. Also, our review of the processes for issuing driver licenses and ID cards revealed additional opportunities for Motor Vehicles to improve its controls to reduce fraud. For instance, Motor Vehicles has yet to evaluate or implement most of the recommendations of its Anti-Fraud Task Force (task force) on ways to reduce driver license and ID card fraud. Finally, since the new fraud prevention procedures have increased the average waiting times of customers with appointments by 1.5 minutes and customers without appointments by 9.3 minutes, Motor Vehicles needs to continue its efforts to improve customer service and mitigate this effect.

To further improve its existing controls and reduce waiting times for customers at field offices, Motor Vehicles should take the following steps:

- Instruct its Driver License Fraud Analysis Unit (Fraud Analysis) to conduct a study to determine the benefits of verifying identification by comparing new photos of existing customers obtaining temporary licenses, driver licenses, or ID cards with photos already in the Motor Vehicles' database.
- Establish deadlines for staff to address all of the task force recommendations and conduct a timely evaluation of the merits of each recommendation.
- Continue its efforts to decrease field office waiting times by installing additional electronic traffic management systems and posting real-time data to its Web site. Also, it should

complete a staffing analysis to assess the impact that the recent reforms have had on its ability to carry out its procedures.

***Motor Vehicles' Action: Partial corrective action taken.***

Motor Vehicles randomly selected a sample of 700 driver license records from transactions completed in its largest offices over a one-month period. Fraud Analysis compared new photos against photo histories and discovered two fraudulent records and four errors. Motor Vehicles concluded that the resources necessary to perform this check would be significant and cannot be justified based on these findings.

Motor Vehicles reports that 27 task force recommendations have been implemented. However, it also found that 4 recommendations were unfeasible and 5 recommendations would require funding and legislation. Motor Vehicles expects to complete the review of another 24 task force recommendations by March 31, 2003.

Motor Vehicles stated that it installed electronic traffic management systems in 32 field offices and all 8 regional offices as of September 2002. Its plans for the procurement phase of the second year of the project are underway. Motor Vehicles anticipates posting wait time data on its Web site for offices with electronic traffic management systems beginning in December 2002. Finally, Motor Vehicles reports that it is in the process of completing a staffing analysis to assess the impact of recent reforms. Preliminary results indicate a potential need for 117 additional positions to carry out the new fraud procedures.

**Finding #4: Motor Vehicles fraud detection training needs improvement.**

Motor Vehicles is not maximizing the benefits of its training course in detecting fraudulent documents. The Field Operations Division (Field Operations) and field office managers' goals conflict regarding which employees should receive the training. Also, database flaws prevent Field Operations from knowing if it even meets its goals. Further, in interviewing trainees and reviewing departmental evaluations, we found significant concerns with the trainers, the curriculum, and available resources. Problems include a lack of hands-on experience with original documents, uniformity among trainers' presentations, and time to cover the material. Consequently, the training is less

useful to employees responsible for fraud detection and prevention and a less effective tool for Motor Vehicles in its efforts to reduce the issuance of fraudulent driver licenses and ID cards.

To improve its fraudulent document detection training, Motor Vehicles should take the following steps:

- Instruct Field Operations management to meet with field office managers to reiterate training expectations and monitor them for compliance with Field Operations' training goals.
- Correct training database errors and modify the Departmental Training Branch's database to allow users to view and sort employees' attendance at the training course for fraudulent document detection by reporting unit location.
- Continue to communicate with trainers and supervisors regarding Motor Vehicles' commitment to standardization and uniformity. Determine if additional funding is necessary to improve its training program.

***Motor Vehicles' Action: Partial corrective action taken.***

Field Operations management has reiterated to field office managers its training expectations and short- and long-term training goals as they relate to fraudulent document detection training. Additionally, it generates a weekly report to reflect all field office personnel who have received this training and shares this information with region and office managers monthly.

Motor Vehicles states that discrepancies in the tracking of training for fraudulent document detection have been identified and resolved. The Departmental Training Branch also requested a modification of its tracking system to allow viewing and sorting of the information by reporting unit location. It continues to meet with investigation staff quarterly to compare databases and review tracking procedures.

Motor Vehicles reports that regular meetings are held with divisional trainers and a standard lesson plan and PowerPoint presentation are used to ensure uniformity of training. Additionally, non-investigative staff will be assuming responsibility for training field representatives in the recognition of fraudulent documents. Motor Vehicles anticipates that its use of fewer trainers will also lead to increased standardization and uniformity in training.

**Finding #5: Missing procedures and flawed data prevent Motor Vehicles from properly managing its fraud complaints.**

Despite its safeguards against driver license and ID card fraud, Motor Vehicles finds that both customers and employees sometimes violate procedures and break the law. Motor Vehicles' Investigations and Audits Division (Investigations) is responsible for looking into cases of possible fraud. However, a lack of procedures and resources hinder Investigations' inquiries into driver license and ID card fraud. Without improvements, Investigations will remain limited in how well it can carry out its mission of stopping fraud, assisting victims, and helping to prosecute wrongdoers. For example, the Field Investigations Branch (Field Investigations) lacks procedures dictating how its staff should manage and resolve complaints. Consequently, Motor Vehicles cannot accurately determine how long it takes to conduct an investigation from start to finish and what its true staffing needs are. A weakness in Field Investigations' case management database also prevents its investigators from sharing information such as current fraud trends. Finally, Fraud Analysis lacks sufficient staffing to handle an increased workload caused by Motor Vehicles' new fraud prevention procedures and consumer fraud hotline.

To increase its effectiveness in preventing fraud, assisting victims, and helping to prosecute wrongdoers, Motor Vehicles should take these actions:

- Establish procedures to more effectively manage its complaints and track accurate data. These procedures should cover, at a minimum, logging a complaint on receipt, promptly sending an acknowledgment letter to the complainant, prioritizing and assigning complaints, and deadlines for completing the investigation and reporting the results.
- Evaluate the feasibility of upgrading the case management database so that field offices can share data.
- Evaluate the staffing needs of Investigations' branches and units.

***Motor Vehicles' Action: Partial corrective action taken.***

Motor Vehicles reports that Investigations' case management database has been expanded to incorporate information regarding all complaints received. Additionally, policies and procedures were finalized that establish responsibilities for complainant correspondence, investigative case prioritization, assignment, due dates, and reporting requirements.

Motor Vehicles anticipates training its investigative staff on these new policies and procedures after the start of 2003.

Motor Vehicles reports that the case management database has been modified so that all investigative field offices can share data.

Investigations is implementing a new management and organizational structure. A deputy director was appointed in March 2002 and testing is in process for two deputy chief investigators. Once these positions are filled, planned organizational changes can be completed. Investigations' management team will be responsible for evaluating staffing needs.

**Finding #6: Clearer policies and definitions are needed to ensure that Motor Vehicles' Special Investigations Branch receives all employee fraud cases.**

Motor Vehicles has not established a clear policy that precisely identifies the role of the Special Investigations Branch (Special Investigations) in investigating employee misconduct. Moreover, clear definitions of employee misconduct and fraudulent or dishonest behavior do not exist, creating inconsistencies in staff reports of possible fraudulent activity. Until it clearly establishes definitions and policies, and identifies Special Investigations' role in investigating employee misconduct, Motor Vehicles cannot ensure that it investigates all questionable employee activities or that employees participating in these activities receive consistent discipline.

To increase its effectiveness in preventing employee fraud, Motor Vehicles should establish a clear policy that identifies Special Investigations' role in investigating employee misconduct; defines such misconduct; and clarifies how employees, managers, and regional administrators are to report employee misconduct.

***Motor Vehicles' Action: Corrective action taken.***

Motor Vehicles reports that it developed a new policy for reporting employee misconduct. The policy entitled "Policy Concerning Employee Criminal Misconduct Investigation" was distributed in March 2002 and identifies Special Investigations' role in investigating employee misconduct, defines misconduct, and clarifies how employees, managers, and regional administrators are to report employee misconduct. This information will also be taught in all new employee orientation classes.



# DEPARTMENT OF TRANSPORTATION

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## ***Its Seismic Retrofit Expenditures Generally Comply With the Bond Act, and It Has Begun to Reimburse the Interim Funding for Fiscal Years 1994–95 and 1995–96***

REPORT NUMBER 2001-010, DECEMBER 2001

Department of Transportation's response as of December 2002

In March 1996 California voters approved the Seismic Retrofit Bond Act (Bond Act), which authorized the State to sell \$2 billion in general obligation bonds to reconstruct, replace, or retrofit state-owned highways and bridges. Legislation passed in 1995 requires the Bureau of State Audits to ensure that projects funded by the Bond Act are consistent with that measure's purposes. This is the sixth in a series of annual reports on the Department of Transportation's (department) revenues and expenditures authorized by the Bond Act.

Overall, the department has moved forward toward its goal of retrofitting more than 1,150 state-owned highway bridges and 7 state-owned toll bridges. As of June 30, 2001, the department has spent \$1.49 billion for retrofit projects and had completed work on 98.1 percent of the highway bridges and 2 of the 7 toll bridges. In addition, as required by the Bond Act, the department has begun to reimburse other accounts for interim funding obtained during fiscal years 1994–95 and 1995–96. During those years, the State Highway Account (highway account) and the Consolidated Toll Bridge Fund (toll bridge fund) provided a total of \$114 million for the retrofitting of California's bridges. As of June 30, 2001, the department had reimbursed the highway account \$26.3 million and it intends to fully reimburse both the highway account and the toll bridge fund before the Bond Act expires in 2005.

**Finding: The department inappropriately charged some expenditures to seismic retrofit projects.**

In general, the department has done a good job of ensuring that its seismic retrofit projects meet the criteria for funding outlined by the Bond Act. However, we found two instances in which the



department charged expenditures to the Bond Act that were not eligible for such funding. In both instances, department staff stated that they were unaware of the department's policies requiring the allocation of certain types of facility costs. As a result, the staff inappropriately charged approximately \$6,800 for a lease payment and a repair bill entirely to seismic projects rather than allocating the amount among seismic and nonseismic projects that benefited from the expenditure.

To ensure that Bond Act proceeds are used only to pay for eligible expenditures under the Bond Act, we recommended that the department direct its staff to follow its policy of allocating facility costs among all projects benefiting from the expenditure.

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

According to the department, it updated its supplemental administrative guidelines to reflect its policy of allocating certain types of costs, such as lease payments and repairs, among all projects benefiting from the expenditures. Further, the department's management continues to reinforce this policy through staff meetings. Finally, our review for fiscal year 2001–02, completed in December 2002, found that the department made appropriate charges to seismic retrofit projects.

# RED LIGHT CAMERA PROGRAMS

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## ***Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level***

REPORT NUMBER 2001-125, JULY 2002

Audit responses as of September 2002 to December 2002<sup>1</sup>

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

*Red light cameras have contributed to a reduction of accidents; however, our review of seven local governments found weaknesses in the way they are operating their programs that make them vulnerable to legal challenge. Specifically, we found that the local governments:*

- ☒ *Need to more rigorously supervise vendors to maintain control of their programs.*
- ☒ *All but one would use photographs as evidence in criminal proceedings even though it would appear to conflict with the law governing the program.*
- ☒ *Generally follow required time intervals for yellow lights.*

*Of the local governments we visited, only San Diego and Oxnard have generated significant revenue from their red light camera programs.*

*Our review of available data shows that red light accident rates decreased between 3 percent and 21 percent after red light cameras were installed by five of the local governments in our sample.*

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The Joint Legislative Audit Committee (audit committee) asked us to review the implementation, application, and efficacy of red light camera programs statewide. We found that accidents related to motorists running red lights have generally decreased where local governments have employed cameras. However, the seven local governments we reviewed—Fremont, Oxnard, Los Angeles County (Los Angeles), Long Beach, the city of San Diego (San Diego), the city of Sacramento (Sacramento), and the city and county of San Francisco (San Francisco)—need to make operational improvements to maintain effective control of their programs, comply with state law, and avoid legal challenges.

### **Finding #1: Local governments have been challenged on their control of red light camera programs.**

Several local governments have been taken to court by alleged red light violators who claim that the local governments are not operating their red light camera programs as required under the law. Although the law stipulates that only a government agency, in cooperation with a law enforcement agency, can operate a program, it offers no further explanation or definition of what operate means, leaving the term open to interpretation. Because local governments contract out the bulk of services for these programs, private sector vendors inevitably play an important role. However, if municipalities delegate too much responsibility, they run the risk of their program being perceived as vendor controlled. For example, a court found that San Diego failed to satisfy the plain meaning of the word operate and that it had no

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<sup>1</sup> Each of the seven auditee's responses were received on the following dates: San Francisco and Los Angeles, September 2002; Fremont, October 2002; Long Beach, San Diego, and Oxnard, November 2002; and Sacramento, December 2002.

involvement with or supervision over, the ongoing operation of the program and concluded that San Diego exhibited a lack of oversight. San Francisco is in the early stages of defending itself against a similar lawsuit. However, a court ruled in favor of Beverly Hills, which was also the subject of a lawsuit alleging concerns over program operations like those in San Diego.

We recommended that to ensure local governments maintain control and operate their red light camera programs and avoid legal challenge, the Legislature should consider clarifying the law to define the tasks that a local government must perform to operate a red light camera program and the tasks that can be delegated to a vendor.

***Legislative Action: None.***

No legislative action found.

**Finding #2: Local governments must more rigorously supervise vendors to retain program control.**

We found that the local governments we visited do not exercise enough oversight of their vendors to avoid the risk of legal challenge over who operates their red light camera programs. Best practices for oversight consists of several elements to monitor and control vendor activities. Such oversight includes strong provisions in local governments' contracts with vendors to protect the confidentiality of motorists' photographs and personal data, making periodic site visits to inspect the vendor's operations for compliance with the law and contract terms, establishing criteria for screening violations, having controls in place to ensure that the vendor only mails properly authorized and approved citations, making decisions as to how long certain confidential data should be retained, and conducting periodic technical inspections of red light camera intersections. However, at the outset of our review, we found that the seven local governments did not exhibit all of the oversight elements we believe are needed to avoid legal challenge. After our inquiries, Long Beach took steps to amend the contract with its vendor to address two elements of oversight that were absent.

To maintain control over their programs and minimize the risk of legal challenges, we recommended that local governments conduct more rigorous oversight of vendors by employing all of the oversight elements we identified.

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

The seven local governments for which this finding applied reported the following corrective actions:

**Fremont:** Fremont reports that it has begun weekly spot checks of intersections with red light cameras and during its next visit of the vendor's operations, Fremont will discuss with the vendor the criteria it uses to purge confidential documents. Fremont did not report action on our finding that it lacks a specific contract provision that makes the misuse of the photographs a breach of the contract.

**Long Beach:** Long Beach reports amending its vendor contract to specifically state that photographs are confidential and to include a provision on when to destroy confidential documents. Further, Long Beach reports implementing a procedure to reconcile citations it has approved against those that the vendor has mailed.

**Los Angeles:** Los Angeles reports taking several actions to address our recommendations. In August 2002, it conducted an oversight visit of the vendor and it plans to perform other visits periodically. During future visits, Los Angeles intends to review a sample of photographs and citations to ensure that only authorized violation photographs result in a citation being mailed to the registered owner of the offending vehicles. In regards to developing business rules, Los Angeles believes that the contract with its vendor includes sufficiently detailed procedures for screening and processing violations, but plans to add clauses to specify the appropriate time periods for destruction of confidential information and to protect the confidentiality of this information. Finally, Los Angeles is evaluating whether to use an independent engineering firm to review camera settings and calibration.

**Oxnard:** Oxnard indicates that it will be changing vendors in early 2003 and that it intends to incorporate our recommendations into the contract with the new vendor.

**Sacramento:** Sacramento reports restarting its program in October 2002 as a joint photo enforcement program with the Sacramento County Sheriff's Department (sheriff's department). Under the supervision of sheriff's department staff, Sacramento City police officers now perform the citation screening, processing, and mailing functions that the vendor previously performed. The vendor continues to maintain the cameras, develop the film and convert it to

digital images, and archive the film. However, Sacramento indicates that it will continue to retain all photographs relating to unenforced citations for three years because the city attorney believes it is necessary to comply with California Government Code, Section 34090 and a city council resolution. Also, Sacramento does not intend to review the need for revising the contract language for protecting the confidentiality of photographs until the contract expires.

**San Diego:** San Diego indicates that it will be restarting the program using the same vendor and that the revised vendor contract will incorporate our recommendations. Specifically, San Diego reports that it has developed business rules to provide accountability over the vendor as well as to ensure San Diego's maintenance and proper control over the program. In addition, San Diego plans to perform ongoing inspections of the vendor's operations.

**San Francisco:** San Francisco reports taking several actions to address our recommendations. It now conducts all team meetings at the vendor's facility and intends to inspect the vendor's facility to ensure that confidential information is being safeguarded. In addition, San Francisco plans to conduct quarterly inspections of camera settings and to determine whether the system is functioning properly. Further, every two months, San Francisco indicates it will reconcile authorized citations with those mailed to ensure that only authorized citations are mailed. Finally, it has amended the vendor contract to require the vendor to destroy all data related to unenforced violations.

**Finding #3: Most local governments believe photographs can be used for other law enforcement purposes.**

According to state law, photographs captured by red light cameras are to be used only for enforcing compliance with traffic signals. However, local governments have differing interpretations of the confidentiality of the photographs taken by red light cameras. Six of the seven local governments in our sample acknowledged that they have used or would use the photographs for purposes other than enforcing red light violations, such as investigating unrelated crimes. According to our legal counsel, a literal reading of the statute prohibits use of the photographs for purposes other than to prosecute motorists for running red lights. However, several jurisdictions believe that other laws, as well as the California Constitution,

would permit the use of red light photographs as evidence in criminal proceedings. According to our legal counsel, in view of the conflicting interpretation of the law, the courts will ultimately decide whether local governments are violating the red light camera law when they use photographs in criminal investigations. The California Constitution also provides that with a two-thirds vote of its members, the Legislature can specifically exclude certain evidence from criminal proceedings, and according to our legal counsel, this would likely include photographs related to traffic signal enforcement.

Because a potential conflict exists between the confidentiality provision in the Vehicle Code and the California Constitution regarding the admissibility of evidence, we recommended that the Legislature consider clarifying the Vehicle Code to state whether photographs taken by red light cameras can be used for other law enforcement purposes.

***Legislative Action: None.***

No legislative action found.

**Finding #4: Local governments may not have addressed engineering improvements before installing red light cameras.**

Although we found that traffic safety was usually the reason for selecting intersections for red light camera enforcement, we could not always verify that local governments addressed engineering solutions before placing red light cameras at intersections. The Federal Highway Administration recommends that before installing a red light camera system, traffic engineers review the engineering aspects of the potential sites to determine whether the problem of vehicles running red lights could be mitigated by engineering changes or improvements. San Francisco best demonstrated that it met this best practice, while the other local governments we visited conducted their engineering improvements on a more informal and ongoing basis.

We recommended that before installing red light cameras, local governments should first consider whether engineering measures, such as improving signal light visibility or using warning signs to alert motorists of an upcoming traffic signal, would improve traffic safety and be more effective in addressing red light violations.

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

The six local governments for which this finding applied reported the following corrective actions:



**Fremont:** Fremont has not reported the action it plans to take on this recommendation.

**Long Beach:** In its response to the audit, Long Beach indicated that for all future locations, it would conduct a specific engineering review to determine if there are any engineering measures not previously noted that could be applied to potentially reduce red light violations.



**Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.

**Oxnard:** Oxnard indicates that it will be changing vendors in early 2003 and that it intends to incorporate this recommendation into the program at that time.



**Sacramento:** Although Sacramento indicates that engineering improvements should be addressed before using red light cameras, it has not reported how it will address this recommendation.



**San Diego:** Although San Diego indicates that the police and transportation departments will be working closely in a more clearly defined partnership to manage the program, San Diego has not reported how it will address this recommendation.

**Finding #5: Some local governments bypassed state-owned intersections with high accident rates.**

Caltrans allows red light cameras at state-owned intersections but requires an encroachment permit for construction. The time it takes to obtain an encroachment permit—which grants the local government access to a state right-of-way for construction—was viewed differently among the local governments we visited. Fremont and Long Beach avoided placing red light cameras at state-owned intersections because they anticipated that the Caltrans permitting process would be too cumbersome and would unnecessarily delay the start of their programs. San Diego stated that Caltrans was unwilling to allow red light cameras on state-owned intersections, but the city could not provide evidence of Caltrans' refusal. Also, Los Angeles did not consider state-owned intersections for its program. By avoiding state-owned intersections, these local governments failed to place cameras at some of the more dangerous intersections within their jurisdictions.

To focus on traffic safety and to avoid overlooking high-accident locations that are state owned when considering where to place red light cameras, we recommended that local governments diligently pursue the required Caltrans permitting process, even though it may cause some delays to their programs.

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

The four local governments for which this finding applied reported the following corrective actions:

**Fremont:** Fremont reports that it will diligently pursue the installation of red light cameras at state-owned intersections after completing its currently selected intersections.

**Long Beach:** In its response to the audit, Long Beach stated that state-owned intersections would be considered if the program is adopted permanently.



**Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.



**San Diego:** Although San Diego indicates that the police and transportation departments will be working closely in a more clearly defined partnership to manage the program, San Diego has not reported how it will address this recommendation.

**Finding #6: Not all local governments require vendors to follow municipal permit and engineering standards when installing red light cameras.**

Local standards may include issuing the proper permits to perform the work, reviewing engineering drawings and plans for the suitability of the work proposed, and inspecting the finished work for accuracy and adherence to the plans and local construction requirements. Six of the seven local governments we visited required vendors to follow local permit and engineering standards to ensure proper construction and inspection of red light camera systems. However, San Diego chose not to apply its local permitting and engineering standards to red light camera intersections. Specifically, San Diego did not ensure that plans were prepared by a registered civil or electrical engineer, nor was the construction subject to the city's formal plan check, permitting, and inspection procedures.



We recommended that to ensure that intersections are constructed and cameras are installed as planned, local governments should follow their own permit processes by reviewing the as-built plans and inspecting the intersection after construction.

***Local Government Action: None.***

The one local government for which this finding applied reported the following corrective actions:

**San Diego:** Although San Diego indicates that the police and transportation departments will be working more closely in more clearly defined partnership to manage the program, San Diego has not reported how it will address this recommendation.

**Finding #7: Caltrans guidance to local governments related to yellow light time intervals could be more specific.**

With few exceptions, the local governments we visited complied with a new law requiring that the minimum yellow light time interval at intersections with red light cameras meet the standards established by Caltrans. The law became effective January 1, 2002, and was prompted by the Legislature's concern that yellow light time intervals at such intersections may be shorter than Caltrans' standards. Caltrans' standards use the speed of the approaching traffic to determine the appropriate time interval for a yellow light. However, the Caltrans traffic manual does not specify how traffic engineers are to determine the speed of the approaching traffic, which can be done in one of two ways: using the posted speed limit or surveying the traffic speed. Therefore, local governments that do not meet Caltrans' standards using both posted speeds and speed survey results run the risk that their yellow light time intervals may be legally challenged.

To avoid the risk of legal challenges, we recommended that local governments petition Caltrans to clarify its traffic manual to explain when local governments should use either posted speeds or the results from speed surveys to establish yellow light time intervals at intersections equipped with red light cameras.

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

The seven local governments for which this finding applied reported the following corrective actions:

**Fremont:** Fremont has not reported the action it plans to take on this recommendation.

**Long Beach:** In its response to the audit, Long Beach promised to request that Caltrans clarify the traffic manual and that it would ensure that its yellow light time intervals are set according to the traffic manual and based on speed surveys.



**Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.

**Oxnard:** Oxnard indicates that it will be changing vendors in early 2003 and that it intends to incorporate this recommendation into the program at that time.



**Sacramento:** Sacramento has not reported how it will address this recommendation.



**San Diego:** Although San Diego indicates that the police and transportation departments will be working closely in a more clearly defined partnership to manage the program, San Diego has not reported how it will address this recommendation.

**San Francisco:** San Francisco reports that it intends to seek confirmation from Caltrans regarding its current practices for yellow light time intervals.

**Finding #8: Accounting for program revenues and expenditures is weak.**

Although good internal control practices dictate that local governments properly account for the revenues and expenditures of their respective red light camera program, only Fremont did so. Because each local government pays their respective vendor based on the number of red light citations that motorists' pay, it would be prudent for them to properly account for program revenues. Additionally, we found that only Fremont and Long Beach conduct monthly reconciliations of their vendors' invoices with the courts' payment records to ensure that they are paying their vendors the appropriate amount. Also, San Diego, San Francisco, and Oxnard could only provide us with estimates for some of their program costs. Without a more precise method of accounting for program expenditures,

these local governments cannot accurately determine the cost-effectiveness of their programs and ensure that local resources are used appropriately.

To allow for better accountability over red light camera programs and to ensure that vendors are paid appropriately, we recommended that local governments improve their methods of tracking revenues and expenditures related to their programs.

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

The five local governments for which this finding applied reported the following corrective actions:

- ➡ **Los Angeles:** Los Angeles has not reported the action it plans to take on this recommendation.
- ➡ **Oxnard:** Oxnard indicates that it will be changing vendors in early 2003 and that it intends to incorporate our recommendations into the program at that time.
- ➡ **Sacramento:** Sacramento indicates that it hopes the partnership with the Sacramento County Sheriff's Department will improve accountability over the program, but it does not indicate specific actions that will occur to implement this recommendation.
- ➡ **San Diego:** San Diego has not reported the action it plans to take on this recommendation.
- ➡ **San Francisco:** To more accurately calculate expenditures, San Francisco reports that it is looking into setting up an accounting procedure to track police effort on the program.

# DEPARTMENT OF TRANSPORTATION

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## ***It Manages the State Highway Operation and Protection Program Adequately, but It Can Make Improvements***

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

*Our review of the California Department of Transportation's (Caltrans) management of its State Highway Operation and Protection Program (SHOPP) found that:*

- ☒ *Most SHOPP projects do not exceed their original funding allocation. Also, although most of the 20 projects we reviewed experienced time delays, the causes for the delays appear reasonable.*
  - ☒ *Resident engineers did not always maintain complete records of project events. Without these records, Caltrans is vulnerable to contractor claims for more money and cannot accurately assess contractors for liquidated damages.*
  - ☒ *Caltrans does not evaluate the financial stability of the surety insurers that issue performance and payment bonds to its contractors.*
  - ☒ *Caltrans lacks comprehensive policies and procedures instructing district staff on how to document and address complaints from the public regarding projects.*
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**REPORT NUMBER 2002-103, AUGUST 2002**

**Department of Transportation's response as of October 2002**

The Bureau of State Audits examined the California Department of Transportation's (Caltrans) process for managing State Highway Operation and Protection Program projects. Specifically, we were asked to determine whether Caltrans is managing projects to ensure minimal or no cost overruns and time delays, contractors have valid performance bonds from solvent companies, and staff follow Caltrans' public relations policies and procedures.

### **Finding #1: Some Construction Engineers Do Not Adhere to Caltrans' Policies for Managing Projects**

Some resident engineers, who manage the project construction costs and administer the contracts, are failing to keep adequate records of days with adverse weather conditions and days that contractors choose not to work on scheduled tasks. Thus, the State lacks necessary records of the causes for project delays and may not be able to assess and collect damages in disputes with contractors about days when they did not work. Also, some resident engineers do not get the required prior approval from the Division of Construction or the district director for construction change orders, which can lead to delays in processing the change orders and to interest charges for late payments to the contractors.

To ensure an adequate defense against contract disputes and to properly assess liquidated damages, Caltrans should ensure that resident engineers and assistant resident engineers maintain complete and accurate daily records of all relevant events occurring on working and nonworking days and that resident engineers complete the weekly statements accurately and in a timely manner. Further, Caltrans should ensure that its staff obtain prior approval for construction change orders

in a timely manner to avoid incurring any unnecessary costs, such as interest for late payments to the contractor, and to ensure that managers agree that proposed changes are necessary. Finally, to aid staff in properly managing construction projects, Caltrans should continue implementing its capital project skill development plan and ensure that staff continue to receive training after the plan expires.

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

Caltrans states that it convened a statewide meeting with its construction deputy directors to reiterate its policies and procedures and to improve its contract administration processes. For example, Caltrans is researching opportunities to further improve contract administration through automation and plans to evaluate its procedures in the spring of 2003. However, Caltrans is uncertain whether it will continue its capital project skill development program and related staff training beyond the current fiscal year, because it is subject to the budgetary process.

**Finding #2: Although Somewhat Limited by State Law, Caltrans Can Reduce the Risk of Loss to the State From Poor Contractor Performance**

Caltrans relies on state-required performance and payment bonds issued by a surety insurer (insurer) for loss protection when contractors fail to do the work as specified in the contract. However, although state law permits Caltrans to obtain financial statements from insurers, Caltrans believes it lacks authority to use those statements. Thus, it does not examine the insurer's financial statements, either at the beginning of or during a project, to evaluate its ability to cover possible project losses. However, because state law prevents Caltrans from knowing that the state's Department of Insurance is investigating an insurer that is on its list of approved insurers, it is important that Caltrans does its own checking of insurer's financial statements to reduce its risk of loss.

To ensure that Caltrans can collect on a performance bond if a contractor does not perform, we recommended that the Legislature consider expanding Caltrans' ability to use other financial indicators included within the financial statements and information available from rating companies such as A.M. Best Company and S&P as a basis for determining the sufficiency of an insurer, before accepting performance bonds.

Further, the Legislature should clarify Caltrans' authority to use the information it obtains from financial statements and other financial indicators to object to the sufficiency of an insurer throughout the bond term.

***Legislative Action: Unknown.***

We are not aware of any legislation that has passed to address this issue.

**Finding #3: Caltrans Can Improve Its Public Relations Process to Avert Negative Publicity**

Caltrans can better meet its goal of communicating effectively with the public about construction projects that inconvenience drivers. Caltrans provides guidance to the district offices, but it relies primarily on them to determine when and how to communicate with the public. Unfortunately, most district public information officers do not track the nature and resolution of the complaints they receive, so public dissatisfaction can grow unbeknown to either the public information officers or Caltrans' headquarters.

To ensure that districts handle complaints and inquiries consistently, Caltrans should develop comprehensive public relations policies and procedures that specify the process to use when responding to complaints, the documents that should be maintained, and the method that district offices should use to assess their public relations efforts. Further, Caltrans should monitor the district offices' public relations efforts periodically.

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

Caltrans' Public Affairs Office has met with division and program managers to discuss the components and actions necessary to develop a comprehensive process to use when responding to complaints about projects. Additionally, Caltrans states that it is continuing to review and modify its existing policies and procedures for handling complaints and inquiries and where necessary, is implementing new policies to ensure timely and consistent responses.



# DEPARTMENT OF VETERANS AFFAIRS

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## ***Weak Management and Poor Internal Controls Have Prevented the Department From Establishing an Effective Cash Collection System***

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

*Our review of the Department of Veterans Affairs' (department) cash management for itself and its three homes for veterans revealed that:*

- ☒ *Since the Department of Health Services decertified the department's Barstow home, the department estimates that this home lost \$5.7 million in federal and state funds through June 2001.*
  - ☒ *Despite its cash flow difficulties, the department has not taken full advantage of all cash sources available to it, and has been slow to bill a substantial number of Medicare claims.*
  - ☒ *The department lacks an understanding of the data in its system, in addition to adequate tools and resources, to allow it to effectively manage the fiscal operations of its veterans homes.*
  - ☒ *The department's August 2001 report of its cash flow needs for fiscal year 2001-02 does not meet the requirements in the Legislature's request, and its December report may also be insufficient.*
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### **REPORT NUMBER 2001-113, DECEMBER 2001**

**Department of Veterans Affairs' response as of December 2002**

The Joint Legislative Audit Committee asked us to examine the Department of Veterans Affairs' (department) management of cash flow for its veterans homes and the central headquarters operations supporting these homes. We found the department has poorly managed its cash and that of its three veterans homes, and it has failed to pursue some reimbursements to which it is entitled. In addition, we noted that the department lacks the tools to manage and control effectively the fiscal operations of its veterans homes, and that its attempts to alleviate its cash flow problems have not been successful. Finally, the department's August 2001 report on its cash flow needs did not meet the requirements in the Legislature's request. Specifically, we found:

#### **Finding #1: The department does not bill for all the services that its homes provide.**

The department faced significant cash shortages because one of its veterans homes has suffered from substandard level of care and because it has not been billing for all of the services that its homes supply to veterans. Specific areas our audit identified include:

- The Department of Health Services (Health Services) withdrew the certification for the Veterans Home of California, Barstow (Barstow home) in July 2000 because of the home's substandard level of care of residents. This decertification prevented the Barstow home from qualifying for federal payments for its daily care of residents and for Medicare and Medi-Cal reimbursements. Consequently, the department estimates that it lost \$5.7 million in federal and state funds from June 13, 2000, through June 2001. To compensate for the loss of these reimbursements, the Legislature authorized additional appropriations totaling \$5.5 million from the State's General Fund.



- The department has not tried to collect the total amount of secondary insurance charges for which it could bill. The department has a policy that directs staff to not spend time billing secondary insurers directly or following up on claims billed automatically by Medicare. Our review indicated that the department's investment of time to perform these additional billings would be negligible, although we did not find that the department would recover large amounts of money from these secondary insurers. Nevertheless, this additional billing does represent a source of reimbursements that the department has not adequately explored.
- Billing errors and lack of adequate documentation may be costing the department additional reimbursements. Of a 100-chart sample of patient charts and their corresponding bills, department consultants noted that 50 charts had no corresponding bills. In the remaining 50 charts for which they could find bills, the consultants noted 158 errors, including 73 cases where the department had not billed or had underbilled for some services and 85 instances in which the department may have billed services erroneously. Neither we nor the department can say with certainty the amount of reimbursements that it may have lost, but given the error rate in the consultant's sample, this number may be significant.
- Staffing issues have contributed to the department's billing problems. Headquarters staff stated that a major contributor to the department's delays in filing claims was the shortage of utilization review nurses and health records technicians. During the period of November 2000 to May 2001, the Veterans Home of California, Yountville (Yountville home) had staff for only one of two budgeted positions for utilization review nurses, and four of six approved positions for health records technicians. The department estimates that these staffing shortages caused the Yountville home to lose \$217,000 in possible reimbursements for skilled nursing care from July 2000 through July 2001. Although the home unsuccessfully tried to hire utilization review nurses on a temporary basis, it did not consider other ways to alleviate its staffing shortage. We also noted that salaries for these positions are lower than the average market wages for similar classifications in state and local government in the San Francisco area where the Yountville home is located.

- The department may have lost additional funds by failing to follow through on recommendations from auditors and consultants. As of October 24, 2001, the department has resolved only 15 of 40 outstanding issues brought to its attention by its billing consultant in calendar year 2000 and again in January 2001. The consultant had noted that the open issues were affecting the department's ability to collect reimbursements for the services provided by the homes.

To ensure that it is billing for all services provided by its three homes for veterans, we recommended the department do the following:

- Continue to seek recertification for its Barstow home so that this home can bill for Medicare and Medi-Cal reimbursements.
- Notify Health Services when the department believes that the Barstow home is ready to undergo a new survey that will lead to recertification.
- Follow up on claims submitted to secondary insurance providers to ensure that it has received reimbursements and that staff reworks rejected or denied claims promptly. In addition, to recover additional reimbursements, the department should submit claims to secondary insurance providers that it has not usually billed.
- Correct the information system and process deficiencies noted by its consulting group in the 100-chart sample. If time limits have not expired, the department should also resubmit claims for the items that it underbilled.
- Consider options to fill utilization review nurse shortages, such as transferring qualified staff to the utilization review section and hiring from nursing registries to replace these staff until the Yountville home can hire and train permanent utilization review nurses and health records technicians.
- Investigate the salary levels and classifications for trained utilization review nurses and health records technicians to determine whether it needs to work with the State Personnel Board to change salary levels for these positions.
- Assign to a department staff member the responsibility for implementing consultant and auditor recommendations. This employee should have sufficient authority to ensure that units in the department complete recommended tasks.

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

The department's one-year response indicated that it had taken the following actions:

- The department notified Health Services that the Barstow home was ready to undergo a new survey on October 25, 2001. Health Services completed its final survey of the home and recertified the Barstow home effective January 17, 2002. The department has resumed billing for service dates from January 17, 2002, forward.
- The department implemented a newer version of its information system on May 7, 2002, to enhance the department's ability to bill secondary payers. In addition, the department retained a consultant to act as its billing intermediary. The department's consultant electronically bills nearly all secondary insurance claims, and is in the process of implementing paper claims billing for those secondary insurers not electronically billed. Moreover, the department is evaluating the value of its contract with its billing intermediary.
- The department corrected the procedural deficiencies noted by its consulting group in the 100-chart sample. Additionally, the department was able to provide valid documentation to bill 42 of the 50 accounts with possible information system and/or process deficiencies for a total amount received of \$100,321.
- After its two utilization review nurses left the department during the first week of October 2002, the Yountville home interviewed several candidates and made a commitment to hire one of the applicants. The Yountville home continues to advertise to fill the remaining vacant utilization nurse position. To reduce the risk of this situation occurring in the future, the department is developing a training plan, pending fiscal support, utilizing outside resources to educate and proctor the new employee. In addition, the department plans to cross-train three in-house employees simultaneously to ensure that experienced back-up staff is available.
- Based on its recently completed audit and salary comparison, the department believes that current salary levels for utilization review nurses are adequate, and that salary

levels for health record technicians will be adequate after the 5 percent salary increase in July 2003. Therefore, the department does not plan to forward salary adjustment requests to the Department of Personnel Administration or the State Personnel Board.

- The department assigned responsibility for implementing consultant and auditor recommendations for financial management to the chief of the financial services division. Other findings are routinely assigned to appropriate staff, as determined by the findings, for follow-up. Also, the implementation of recommendations is tracked by the financial management section and reported to the chief of the financial services division. The department is evaluating how to reestablish an independent internal audit function outside the financial services division as a result of the passage of Senate Bill 1858 (Chapter 977, Statutes of 2002).

**Finding #2: The department does not bill promptly for its services.**

The department has further compounded its cash flow difficulties by failing to submit promptly its claims for certain reimbursements. The department failed to bill Medicare for outpatient services provided by one of its homes between August 2000 and June 2001 until June 2001 because, in part, its employees did not understand how policy changes made by the federal government would affect the department's billing procedures. However, we did not find this 10-month delay to be reasonable because the department had sufficient notice of the federal government's planned policy revisions to begin making changes to its billing system. Our testing of a sample of 44 claims generated during fiscal year 2000–01 revealed that the department averaged 207 days from the last date of service to the date that it submitted the claims to Medicare for the 25 claims that it billed. For these 25 claims, Medicare averaged 27 days from the date the department submitted the bills to the date that the federal agency either paid or rejected them.

We recommended that the department continue to focus on clearing its backlog of claims and ensuring that staff perform all tasks related to billing to ensure that it is billing claims promptly.

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

The department transferred 1,503 accounts, with an accounts receivable of \$3.6 million, to its consultant. The department's consultant collected \$787,058 on behalf of the department, with the remainder written off as insurance contractual adjustments, noncovered services, or self-pay. The department paid its consultant \$138,266 for its services.

Further, the department reported that it cleared its coding backlog for 2000 and 2001 on December 1, 2001. Currently, the department reports that it has approximately 1,000 claims in the system that will need further documentation or clarification from the service areas before final coding can be completed.

With regard to ensuring that staff perform all tasks related to billing to ensure that it bills claims promptly, the Yountville home reports that all utilization review notices are current, and all approved stays with accounts finalized by its medical administrative services unit have been billed up to September 2002. Because the two utilization review nurse positions have been vacant since the first week of October 2002, billing on new accounts are being held in reimbursements while the new utilization review nurse is fully trained.

**Finding #3: Insufficient information hampers the department's management of reimbursements.**

The department lacks sufficient knowledge of the data in its billing management information system (information system), which has caused the department to overestimate the total reimbursements that it believes it can recover. In July 2001 the department retained a consultant to assist in billing outstanding charges, estimating that the consultant could recover up to \$6 million. However, as of September 30, 2001, the department's consultant has been able to recover only between \$350,000 and \$450,000. Erroneous accounts in its system prevent the department from accurately determining how many accounts remain that it can bill. For example, as of August 31, 2001, the Yountville home had 3,076 outpatient clinical accounts with no charges from fiscal year 2000–01. Our testing of 309 of these accounts revealed that 22 accounts had actual charges totaling almost \$4,800 that should have been entered and processed for billing. We also found charge slips for 19 accounts for which the

home provided services but that were not billable to an insurance provider. We could not find charge slips for the remaining 268 accounts.

To ensure that it has a sufficient understanding of the accounts and data in its information system, the department should do the following:

- Analyze costs and benefits of continuing to hire consultants to bill for prior-year charges to determine whether reimbursements will adequately cover costs for hiring consultants. Further, if the department decides to keep its current information system, it should hire a consultant knowledgeable in the department's current information system to assist the department in cleaning up erroneous data, applying credits to accounts for which payments have been received, and processing all unbilled charges in the system, in addition to assisting the department in developing written business policies and practices and training staff.
- Finish implementing a system of numbered charge slips to ensure that all staff at its veterans homes have entered all data.
- Investigate accounts with no charges to determine whether the department can submit claims or should delete these accounts.

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

The department's one-year response indicated that it had taken the following actions:

- The department reports that it is continuing to contract with outside consultants in order to recoup prior- and current-year funds until it conducts a feasibility study to identify the true costs of moving from its current information system to a different one. In the meantime, the department stated it has installed upgrades to its current system, which has improved the system's functionality. Further, the department reported that its Information Technology Council is in the process of evaluating off-the-shelf information system capabilities within the same operational environment as the homes.
- The department reported that since November 2001, it has assigned a full-time staff member as a charge slip coordinator to number and track all charge slips and ensure that all registered appointments have a corresponding

charge slip that is ready to be processed for billing. The department reported that since March 2002, it has been actively tracking charge slips. Additionally, the department plans to implement a new process for tracking and billing physician visits for long-term care patients by the end of the first quarter of 2003.

- The department continues to purge all accounts for services before October 2000, as these accounts are no longer collectible. It also plans to continue producing selection reports to determine if any zero charge accounts are duplicate or incorrectly set-up accounts and will delete these accounts as uncollectible, erroneous accounts.

**Finding #4: The department does not prepare management reports or fully access its information system.**

The department cannot accurately estimate the amount of unbilled charges in its information system because the system includes erroneous amounts. Without sufficient knowledge of the amounts available to it for billing, the department cannot effectively monitor and manage its billing and collection process, nor can it prepare useful management reports. Our review of cash position reports prepared by the department's reimbursements unit from data in the department's information system noted significant differences between totals in this report and totals in the department's accounting system. Because the department's accounting system cannot track unbilled charges, the department may be missing opportunities to collect reimbursements because it cannot evaluate its effectiveness in billing claims using data from that system. Further, the department's information system has tools and reports that can assist management in controlling cash flow; however, management at the department and at the veterans homes appears not to be using many of these. Although the veterans homes use only 41 of 76 modules purchased by the department for their use, the department estimates it will pay \$81,000 to \$251,000 per home to maintain all the modules in fiscal year 2001–02.

We recommended that the department develop periodic management reports, and regularly reconcile these reports with the department's accounting records in order to evaluate the cash flow at headquarters and at all three homes with respect to reimbursements, expenditures, accounts receivable, and unbilled claims.

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

The department has developed a series of reports including cash collections per week by source of revenue, cash flow analysis for each home, and monthly expenditure analysis for each home. These reports are presented to its Home Executive Council, which meets monthly.

**Finding #5: The department's internal controls lack adequate oversight.**

The department's oversight of internal controls has serious shortcomings. Despite its awareness that its internal controls, including its business policies and practices, exhibit consistent deficiencies, the department has not made sufficient effort to correct known problems. In addition, the department has not had an external audit or internal review of its internal controls since 1994. According to our limited review of the department's operations, the department exhibits to some degree most of the warning signs that appear on the State Administrative Manual's list characterizing poor maintenance of an internal control system. For example, the department did not keep current its policies and procedures manuals, and it does not produce accurate operational reports it could use as management tools.

In addition, although the Legislature transferred the responsibility for internal audits to the Inspector General for Veterans Affairs (inspector general), it did not give the inspector general access to all departmental records. Without access to many confidential records, the inspector general is unable to review many of the department's controls.

We recommended that the department ensure that regularly scheduled reviews of its internal controls are performed to provide assurance that the department's mission is carried out and that the department is maintaining effective control over assets, liabilities, reimbursements, and expenditures.

In addition, if the Legislature believes that the intent of its legislation creating the position of inspector general is not being met, it should consider clarifying state law governing the inspector general so that the inspector general has appropriate access to all department records.



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

The department conducts regularly scheduled reviews separately and in conjunction with the inspector general. Furthermore, the results and recommendations of prior reviews will be submitted to the Executive Council of the Veterans Homes or the secretary's office, as appropriate, for implementation.

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

In September 2002, the Legislature passed and the governor signed Senate Bill 1858 (Chapter 977, Statutes of 2002), which gave the California Veterans Board and the inspector general access to all documents and employees of the department.

**Finding #6: The department has demonstrated an inconsistent approach to fiscal management.**

In August 2001 the department proposed a reorganization for the oversight of its homes. Nevertheless, the department has used an inconsistent approach to fiscal management. The department recently returned some tasks to the homes with the goal of enabling each veterans home to better manage its budget, however, it did not ensure that the homes had access to current, accurate data or to a functional information system. Additionally, the department did not give the homes adequate written guidance or performance measures, nor did it enter budget data into its accounting system or list budget targets for the veterans homes until October 2001, three months after the start of the fiscal year.

We recommended that the department continue to define and clarify in writing the division of responsibilities between headquarters and the veterans homes to make certain that expenditure and reimbursement activities have appropriate oversight.

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

The department reports that it has developed an official mission, vision, and value statement, along with goals and objectives for reorganizing its veterans homes division. The department has also developed measures and metrics for staff performance at its homes. The department expects to make substantial progress on the development of the division's scorecard later in the year, which will include a prototype report as part of the home's executive board

operations. Finally, the department is developing an administrative manual for its division concurrently with an overall review of its policies and procedures. Although, as stated in its response to finding 8, it has delayed development of this manual due to lack of resources. As the department develops standardized procedures, it plans to incorporate them into its administrative manual.

**Finding #7: Lack of appropriate training continues to hamper claims processing.**

In general, the department may not have optimized its use of its training dollars for its billing staff. In fiscal year 2000–01, the department spent at least \$66,040 for training, of which only \$1,000 went to training for medical billing. This training was general in nature and did not significantly increase staff's knowledge of billing procedures. An additional \$935 of the \$66,040 training funds went to lost registration costs due to last-minute cancellations by department staff. Moreover, of the 68 training classes offered to Barstow home staff, and 118 hours of training provided to Yountville home medical billing staff, none applied to medical billing. Recent changes in Medicare filing requirements make training critical for the department. Partly because of its staff's lack of billing expertise and knowledge, the department hired a consultant in July 2001 to assist it in processing backlogged claims for October 1, 1999, through June 30, 2001. The contract will cost up to \$400,000, and the department has budgeted \$810,000 for another consultant to assist it in processing claims for fiscal year 2001–02.

The department should provide training opportunities for department staff, particularly staff involved in processing claims, to ensure that they stay informed about current developments in Medicare regulations and policies.

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

The department has provided training classes for its headquarters and home reimbursement staff. Further, a reimbursement staff member continues the task of reviewing all Medicare bulletins and disseminating current policies, procedures, and new regulations to the headquarters billing staff, and to the support and clinical staff at the homes. The department continues to seek training opportunities and funding for both the headquarters and home reimbursement staff.

**Finding #8: Poor management has caused deficiencies in the department's information system.**

The department has not provided adequate leadership to ensure that the veterans homes have a usable information system. Poor management, lack of executive sponsorship, and insufficient training have all contributed to deficiencies and errors in the data recorded in the department's information system. The department has not made certain that staff and management accept the system, nor has it provided sufficient resources, including adequate training, to implement the information system successfully. Finally, the department has failed to fulfill its own as well as its consultants' recommendations for resolving information system issues. These weaknesses have resulted in an information system that does not assist the homes in tracking services provided to patients and in collecting reimbursements for services provided.

The department should decide how it will satisfy its three veterans homes' conflicting needs for an information system, and implement a decision fully supported by management. If it retains its current information system, the department should ensure that it fully develops and completes the data dictionaries and that staff receives adequate training to maintain and operate the information system. We also recommended that the department perform business process reengineering, including developing written business policies and practices that require staff to carry out necessary tasks and to receive adequate training. If it deems it cost-beneficial, the department should consider hiring a consultant to assist it in these tasks and to help the department develop its business solution.

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

The department successfully upgraded its current information system in May 2002. However, the department's Veteran's Home Executive Board concluded, based on input from staff, that a more modern system is required. The department has formed several teams to develop requests for proposal and to determine what limited action must continue with its current system until the department can select and implement a new system.

The department continues to seek funding for business process reengineering, but has not been successful due to the current fiscal environment. The department's efforts in

updating both its reimbursement procedure manual and administrative manual have been delayed, however, the department intends to ensure that as resources become available, it updates its written policies and procedures. Further, the department intends to continue seeking funding for business process reengineering.

**Finding #9: Limiting expenditures was not as effective as the department had anticipated.**

The department has attempted to control its cash flow by limiting expenditures at the homes and at headquarters. However, this has not solved the department's problems with cash management. In fact, the department has actually increased its expenditures since implementing cost-cutting measures in January 2001. The department increased its use of consultants because it has had difficulties obtaining reimbursements from insurers and it signed contracts totaling \$4.7 million for consultant services begun or continued in fiscal year 2000–01. Because the department has decreased its collections of reimbursements from insurers and has been unsuccessful in decreasing expenditures, the State has supplied additional funding for the department. However, this draws on state funds that could be available for other uses.

To better ensure that it meets its cash flow needs, the department should examine its use of consultants to consider how best to allocate resources to obtain needed services. In addition, the department should analyze the costs and benefits of contracting out its billing and collections functions and eliminating excess positions, to determine whether it can avoid paying both consultants and staff to perform similar functions.

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

The department reported that it continued its contract with outside consultants in order to realize all available cash from the accounts receivables. Further, the department contracted with an outside consultant in the fiscal year 2002–03 to become its fiscal intermediary. Based on this contract, the department plans to implement a reorganization plan for its current staff.

**Finding #10: The August report on cash flow does not supply the information requested by the Legislature, and the department's December report may also fall short of legislative requirements.**

The Legislature directed the department to provide a report as of August 31, 2001, that details the department's needs for cash. However, the department did not fulfill this request adequately. Specifically, the department report omits the department's starting cash position, and it does not show expected reimbursement collections or expenditures by month. Our review also noted that rather than offering a cash flow forecast, the department's report merely repeats material from the department's budget from the 2001–02 Final Budget Summary. Although it is working on a new format for the next report, due in December 2001, it has not yet finalized the methodology to estimate accurately its accounts receivable. Additionally, deficiencies in the August 2001 report will render the next report useless for making comparisons. Therefore, the department and the Legislature will be unable to use these reports to determine the causes and fiscal implications of the differences between the reports.

To support and improve its process for developing analyses of its future cash flow needs, the department should continue to prepare the detailed estimates and supporting schedules that it needs for its December 2001 and February 2002 reports to the Legislature.

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

The department reports that it has agreed to continue furnishing the cash flow reports to the Legislature in the current budget year.

# DISABLED VETERAN BUSINESS ENTERPRISE PROGRAM

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## ***Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success***

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

*Our review of the Disabled Veteran Business Enterprise (DVBE) program found that:*

- ☑ *Many awarding departments do not report their DVBE participation levels; of those that do report, most do not meet the 3 percent participation goal.*
- ☑ *The reasonableness of the 3 percent goal itself is not clear.*
- ☑ *Outreach to potential DVBEs should be more aggressive.*

*Other factors that contribute to the State's failure to meet the DVBE goal are:*

- ☑ *The program's overly flexible legal structure and limited clarifying regulations.*
  - ☑ *The frequency with which certain departments exercise their discretion to exempt contracts from DVBE participation.*
  - ☑ *Lack of effective evaluation of bidders' good-faith efforts and monitoring of contractors' compliance with contract DVBE requirements.*
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**REPORT NUMBER 2001-127, JULY 2002**

**Departments of General Services', Transportation, and Health Services and Health and Human Services Agency responses as of January 2003<sup>1</sup>**

The Joint Legislative Audit Committee requested that we determine the extent to which departments that award contracts (awarding departments) are meeting the 3 percent Disabled Veteran Business Enterprise Program (DVBE) participation goal and to identify statutory and procedural mechanisms that could assist in overcoming any barriers to fulfilling this goal. We found that many awarding departments do not report DVBE participation as required under law, and even fewer departments actually meet the goal. Specifically, we found:

**Finding #1: Awarding departments' DVBE participation statistics are not always accurate, and the methodologies they employ are at times flawed.**

State law requires each awarding department to report to the governor, Legislature, the Department of General Services (General Services), and the Department of Veterans Affairs (Veterans Affairs) by January 1 each year on the level of participation by DVBEs in state contracting. General Services then issues a summary report.

Our own review showed that some awarding departments did not report DVBE statistics and others could not always provide supporting documentation for the DVBE statistics they reported. For example, for fiscal year 2000–01, the Department

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<sup>1</sup> Department of Veterans Affairs; Youth and Adult Correctional; State and Consumer Services; Business, Transportation and Housing; and Resources agencies responses as of September 2002.

of Fish and Game (Fish and Game) reported \$12.1 million in DVBE participation but could identify only \$431,000 in specific contracts, or less than 3.6 percent of the total. In addition, the Department of Health Services (Health Services) could not provide any summarized documentation for the numbers it reported. Health Services asserted that it had documentation in individual contract files to support its figures, but indicated it would be too time intensive to tally the information for our review.

Additional problems with the accuracy of DVBE participation information exist. The reporting methodology General Services established is contrary to statutory requirements. According to statute, the 3 percent DVBE participation goal applies to the overall dollar amount expended each year by the awarding department. However, under current reporting regulations issued by General Services, awarding departments must report the amount winning bidders “claim” they will pay to DVBEs under the contract. In its clarifying instructions, General Services has asked awarding departments to report the amounts “awarded” in contracts, rather than amounts actually paid to DVBEs.

To ensure DVBE statistics are accurate and meaningful, we recommended General Services require awarding departments to report actual participation and maintain appropriate documentation of statistics, continue its periodic audits of these figures for accuracy, and, if the audits reveal a pattern of inconsistencies or inaccuracies, address the causes in its reporting instructions.

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

General Services has interpreted the statutes governing DVBE reporting to provide participation statistics to be reported based on the value of contracts awarded instead of dollars actually expended. According to General Services, this is the same methodology used in the small business participation report (California Government Code, Section 14840). General Services believes it is important to use consistent reporting standards to allow for program comparisons. Nevertheless, General Services is revisiting this issue based on the concerns raised by the Bureau of State Audits. However, a General Services’ consultant concluded that reporting actual data would be costly.

As to the issue of requiring departments to maintain documentation of participation statistics, General Services has added an instruction to the new participation report form that addresses the necessity of maintaining supporting documentation. General Services is also continuing to

include the audit of the DVBE reporting process within its comprehensive external compliance audit program performed of other state agencies. The results of these audits are being used to identify areas for possible improvement within the reporting process.

**Finding #2: Not all state agencies have finalized and implemented their plans to monitor their departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, require a DVBE improvement plan.**

In June 2001, the governor issued executive order D-43-01, which requires all state agency secretaries to review the DVBE participation levels achieved by the awarding departments within their agencies. Further, the executive order requires each secretary to require awarding departments to develop an improvement plan if the 3 percent goal is not achieved or the data is not reported. Three of five state agencies responding to our survey indicated that they were still developing procedures to monitor the DVBE participation levels of their subordinate awarding departments.

We recommended those state agencies that have not already done so should finalize and implement their plans to monitor awarding departments' reporting of DVBE statistics and, for those failing to meet the 3 percent goal, monitor their efforts to improve DVBE participation.

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

On June 28, 2002, the Governor directed that all state departments and agencies submit monthly reports to the State and Consumer Services Agency regarding DVBE participation. Based on the reporting forms developed by the State and Consumer Services Agency, state departments and agencies are required to report total contracting dollars, dollars paid to DVBEs, and DVBE participation percentages. In addition, departments that have not met the 3 percent DVBE participation goal are required to explain why.

The Health and Human Services Agency (HHS) indicates that it has established policies to monitor department reporting of DVBE participation. In compliance with the governor's executive order D-43-01, HHS has collected and submitted department improvement plans for increased





DVBE participation. The Business, Transportation and Housing Agency indicates it is monitoring DVBE participation and providing oversight of all its departments and offices. It reports that the agency as a whole exceeded the 3 percent participation goal for fiscal year 2001–02 and thus far in the current fiscal year has further increased its participation rate. The Youth and Adult Correctional Agency; State and Consumer Services Agency; and the Resources Agency did not submit a six-month response addressing this recommendation.

**Finding #3: The State does not know how many DVBEs can be certified and the extent to which they can provide needed goods and services to the State. As a result, the reasonableness of the 3 percent goal is uncertain.**

Even though the law establishes a 3 percent participation goal for every awarding department, our review did not find sufficient evidence to support the assumption that this is an equitable share of contracts for DVBEs. When the DVBE legislation was being drafted in 1989, several awarding departments opposed the bill on the grounds that the 3 percent goal was unrealistic.

The awarding departments' concern about enough DVBEs to justify the 3 percent goal seems to have been valid. As of May 2002, General Services had only 797 DVBEs certified and available for contracting. The services these DVBEs offered and their geographical distribution did not always match the State's needs. All five agencies responding to our survey and many awarding departments' improvement plans identified a limited pool of DVBEs as one of the impediments to meeting the 3 percent DVBE participation goal.

To determine if the 3 percent DVBE goal is reasonable, the Legislature may wish to consider requiring either General Services or Veterans Affairs to commission a study on the potential number of DVBE-eligible firms in the State, the services they provide, and their geographic distribution, and compare this information to the State's contracting needs.

Based on the results of this study, the Legislature may wish to consider doing the following:

- Modify the current DVBE participation goal.

- Allow General Services to negotiate department-specific goals based on individual contracting needs and the ability of the current or potential DVBE pool to satisfy those needs.

***Legislative Action: None.***

We have found no indication that any study on DVBE-eligible firms has been commissioned. Further, the DVBE participation rate remains at 3 percent, while the reasonableness of this goal remains unclear.

***Veterans Affairs' Action: None.***

According to Veterans Affairs' September 2002 update to its response to the audit, it is intending to commission a study on the potential number of DVBE eligible firms in the State. However, it is unclear if this step has been taken because Veterans Affairs has not submitted its six-month update of its response, which was due in December 2002.

**Finding #4: General Services is not sufficiently aggressive or focused in its outreach and promotional efforts for the DVBE program.**

As the administering agency for the DVBE program, General Services has been responsible for certifying eligible businesses as DVBEs and conducting promotional and outreach efforts to increase the number of certified DVBE firms.

It is unclear to what extent General Services' outreach activities target disabled veterans' groups. General Services was also unable to readily quantify its outreach activities. The information it ultimately provided was based on old personal calendars and planners. We also could not evaluate the effectiveness of these outreach activities since General Services only selectively monitors the results.

To ensure the DVBE program is promoted to the fullest extent possible, we recommended General Services aggressively explore outreach opportunities with the U.S. Department of Veterans Affairs and organizations such as the American Legion, Disabled American Veterans, and Veterans of Foreign Wars. In particular, General Services should cultivate a clear working relationship with county veteran service officers. It should also maintain complete records of its outreach and set up a system to track effectiveness. For example, General Services could consistently

survey newly certified DVBEs to determine how they heard about the program and what convinced them to apply for certification. Finally, General Services and Veterans Affairs should continue to work to develop their joint plan for improving the DVBE program, finalizing and implementing it as soon as possible.

***General Services' and Veterans Affairs' Action: None.***

On June 28, 2002, the governor directed the implementation of a more intensive DVBE outreach effort, with the resources dedicated to that effort moved from General Services to Veterans Affairs. According to General Services, on August 1, 2002, the two DGS staff members performing the outreach function physically transferred to Veterans Affairs.



Veterans Affairs has not provided a six-month update to its response on the above recommendation. According to its September 2002 response, Veterans Affairs anticipated having an outreach plan by January 1, 2003.

**Finding #5: Some awarding departments exempt a significant number of contracts, potentially limiting their ability to maximize DVBE participation rates.**

Under statute, the DVBE participation goal applies to an awarding departments' overall expenditures in a given year. Therefore, awarding departments have the discretion to apply DVBE participation requirements on a contract-by-contract basis.

The frequency with which certain awarding departments exempt contracts from DVBE requirements is significant. Further, some of these awarding departments are not tracking the value of the contracts they exempt or the required compensating increase in participation goals for their remaining non-exempt contracts. For fiscal year 2000–01, two of the five awarding departments we reviewed, Health Services and Caltrans, did not compensate for these exemptions with increased participation on other contracts, and subsequently reported they did not meet the participation goal. According to our calculations, Health Services exempted 48 percent of DVBE-eligible contract dollars it reported in fiscal year 2000–01, which means it would have had to average almost 6 percent on all remaining eligible contracts to meet the goal. Similarly, General Services' procurement division estimated that it exempted over 50 percent of its contracts during fiscal year 2000–01.

Awarding departments offer varying reasons for their exemption decisions. Some departments we reviewed exempt all contracts with certain characteristics, and the reasonableness of these blanket decisions may not be clear. For example, at least one unit within four of the five departments we reviewed has indicated it exempts all contracts it believes do not offer a subcontracting opportunity for DVBEs. However, this practice may significantly reduce a department's chances for obtaining more DVBE participation.

To maximize DVBE participation, we recommended awarding departments attempt to use DVBEs as prime contractors instead of viewing them only as subcontractors. Further, the awarding departments should periodically examine the basis for their assumptions behind blanket exemptions for whole categories of contracts to ensure the exemptions are justified.

***General Services', Health Services', and Caltrans' Action: Partial corrective action taken.***

As of January 2003, General Services, Health Services, and Department of Transportation (Caltrans) responded to this recommendation. General Services has restated its policy to staff, stating that all contracts will include a DVBE participation goal unless the chief deputy director grants a waiver from those requirements. Health Services indicates that as of September 2002, its contracting management unit began requesting Health Services' programs to confirm that no certified DVBE firms are available to perform likely subcontract services in the service location. Caltrans indicates that it will mail solicitation packages to qualified DVBEs when contracting opportunities become available for services they can perform.

**Finding #6: Awarding departments do not consistently scrutinize and evaluate good-faith effort documentation or ensure that DVBEs are actually being used as called for in contracts.**

The effectiveness of the implementation of the good-faith effort may be diminished by the lack of consistent or meaningful standards for awarding departments to follow when evaluating bidders' documentation of such efforts. Although statute requires General Services to adopt standards, it has not issued much direction to awarding departments on how to evaluate a bidder's good-faith effort. The State Contracting Manual offers

appropriate suggestions for procedures in assessing good-faith effort, but the suggestions are not binding. There is also no clear requirement in statute requiring awarding departments to monitor actual DVBE participation to ensure the contractor is complying with the contract's DVBE requirements.

A common result of this lack of direction is the cursory evaluation of a bidder's good-faith effort documentation and inconsistent monitoring of actual DVBE usage. For example, Health Services does not instruct staff to independently verify bidders' statements that they solicited DVBEs to participate as subcontractors. Before February 2002, Health Services also lacked policy to monitor actual DVBE participation. Caltrans also does not follow up to ensure the DVBEs that the bidder claimed to have solicited were actually contacted. Although Caltrans' procurement unit did have a policy to monitor actual DVBE participation to ensure contract compliance, we saw no monitoring consistent with this policy in a sample of their contract files.

To ensure that prime contractors make a genuine good-faith effort to find a DVBE, we recommended the Legislature consider requiring awarding departments to follow General Services' policies. General Services should issue regulations on what documentation the awarding departments should require and how they should evaluate that documentation. These standards should include steps that ensure the documentation submitted is accurate. Similarly, General Services should issue regulations on what steps departments should take to ensure contractors meet DVBE program requirements. These steps might include requiring awarding departments to monitor vendor invoices that detail DVBE participation or requiring the vendor and DVBE to submit a joint DVBE utilization report.

***Legislative Action: None.***

We found no indication that the Legislature has required awarding departments to follow General Services' policies regarding the evaluation of bidders' good-faith effort documentation.



***General Services' Action: None.***

General Services has indicated it has not yet had the resources to address this recommendation. However, it plans to review the feasibility of adding the recommended provisions to regulations.

**Finding #7: The efficiency and effectiveness of the DVBE program could be improved with legislation aimed at providing incentives for DVBE participation and penalties for bidders who do not comply with program requirements.**

Legislation establishing the DVBE program does not have adequate provisions to ensure compliance with program goals.

To increase the efficiency and effectiveness of the DVBE program, we recommended the Legislature consider doing the following:

- Replace the current good-faith effort step requiring bidders to contact the federal government with a step directing bidders to contact General Services for a list of certified DVBEs.
- Enact a contracting preference for DVBEs similar to the one for the small business program—that is, allow an artificial downward adjustment to the bids from contractors that plan to use a DVBE to make the bids more competitive.
- Require awarding departments to go through their own good-faith effort in seeking DVBE contractors.
- Provide awarding departments with the authority to withhold a portion of the payments due to contractors when they fail to use DVBEs to the extent specified in their contracts.



***Legislative Action: None.***

We found no indication that the Legislature has passed legislation addressing the recommendations presented above.



# VETERANS HOME OF CALIFORNIA, YOUNTVILLE

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

ALLEGATION I2000-876 (REPORT I2002-2),  
NOVEMBER 2002

Department of Veterans Affairs' response as of August 2002<sup>1</sup>

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

*The Veterans Home of  
California, Yountville  
engaged in the following  
improper governmental activity:*

- ☒ *Improperly billed  
Medicare \$55,000 for  
visits that the staff  
physician did not make.*
- 

We investigated and substantiated that the information system used by the hospital at the Veterans Home of California, Yountville (home), for processing charges for services provided to the home's residents contains charges attributed to one doctor for services that the doctor could not have provided.

### **Finding: The home processed charges for services the doctor could not have provided.**

The information system the home uses to bill Medicare, Medi-Cal, and other insurers showed that one doctor saw patients 2,614 times from July 1, 1999, through July 17, 2001, but we concluded that the doctor did not see a patient in 1,792 (69 percent) of those visits. Some of these excess visits in the system were for patients who were not on the doctor's clinic schedule for that day. In 400 other cases, the doctor was not working on the day in question, including weekends, holidays, and days that she was on vacation or sick leave. Furthermore, 148 incorrectly recorded visits were on 50 days on which the doctor worked from home. As further evidence of the information system's lack of credibility, it indicated that the doctor saw patients on every day of 35 consecutive days spanning August and September 1999, 34 consecutive days spanning June and July 2000, and 26 consecutive days spanning May and June 2001. In fact, the billing system indicated that the doctor saw patients on all but three of the 70 days from July 15

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



through September 22, 1999. As of January 22, 2002, the home had billed Medicare \$131,000 for 1,488 of these 2,614 patient visits. However, \$55,000 was for 887 visits that we concluded the doctor did not make.

***Department Action: Pending.***

The Department of Veterans Affairs (department) reports that it is actively working to upgrade its billing system and is working with its billing agent to resolve any charges billed and reimbursed incorrectly. Further, the department states that it will ensure that it obtains the signature of the attending physician/technician to maintain proper practices and Medicare compliance.

# APPENDIX

## Summary of Recommendations for Legislative Consideration by Policy Area

The Table below presents a summary of the recommendations the Bureau of State Audits made to the Legislature from January 2001 through January 2003. Reports describing these recommendations are also identified in the Table. For the status of the Legislature's actions with regards to these recommendations, refer to the page number listed below.

TABLE

### Recommendations to the Legislature

Report Number and Title	Page	Recommendation
<b>Banking, Finance, Commerce, and International Trade</b>		
<b>2001-115, Technology, Trade and Commerce Agency: Its Strategic Planning Is Fragmented and Incomplete, and Its International Division Needs to Better Coordinate With Other Entities, but Its Economic Development Division Customers Generally Are Satisfied</b>	12	We recommended that the Legislature consider commissioning an independent statewide study of the existing delivery system for export services to determine the best division of work and resources among the various entities in the international arena.
<b>Business and Professions</b>		
<b>2000-117, The State's Real Property Assets: The State Has Identified Surplus Real Property, but Some of Its Property Management Processes Are Ineffective</b>	18	<p>To provide consistency and quality control over the review of the State's real property holdings, we recommended that the Legislature consider empowering an existing agency or creating a new commission or authority with the following responsibilities:</p> <ul style="list-style-type: none"> <li>• Establishing standards for the frequency and content of property reviews and land management plans.</li> <li>• Monitoring agencies' compliance with the standards.</li> <li>• Scrutinizing agencies' property retention decisions.</li> </ul> <p>Alternatively, this entity could be responsible for periodically conducting reviews of the State's real property and making recommendations to the Legislature regarding the property's retention or disposal. If the Legislature does not wish to establish such an oversight entity, it should consider replacing the current requirement for annual property reviews with a requirement for less frequent but more comprehensive reviews. The Legislature should also consider providing incentives to state agencies to encourage them to identify surplus and underused property so that they free the real estate for better uses. Such incentives could include allowing agencies to retain the proceeds from the disposition of surplus properties for use either in funding current or planned capital outlays for new property or in improving and modernizing existing facilities when the need exists. Additionally, when agencies need to acquire or improve facilities, incentives for disposing of excess property could include guaranteeing agencies the market value for the surplus property they sell or transfer.</p>

Report Number and Title	Page	Recommendation
<b>2001-128, Enterprise Licensing Agreement:</b> <i>The State Failed to Exercise Due Diligence When Contracting With Oracle, Potentially Costing Taxpayers Millions of Dollars</i>	73	We recommended that the Legislature consider requiring all Information Technology contracts over a specified dollar amount to receive a legal review by the Department of General Services.
<b>2002-107, Office of Criminal Justice Planning:</b> <i>Experiences Problems in Program Administration, and Alternative Administrative Structures for the Domestic Violence Program Might Improve Program Delivery</i>	88	<p>To improve the efficiency of the State's domestic violence programs and reduce overlap of Office of Criminal Justice Planning's (OCJP) and Department of Health Services' (DHS) administrative activities, we recommended OCJP and DHS, along with the Legislature, should consider implementing one of the following alternatives:</p> <ul style="list-style-type: none"> <li>• Increase coordination between the departments.</li> <li>• Develop a joint grant application for the two departments' shelter-based programs.</li> <li>• Combine the two shelter-based programs at one department.</li> <li>• Completely consolidate all OCJP's and DHS's domestic violence programs.</li> </ul>
<b>Education</b>		
<b>2001-120, School Bus Safety II:</b> <i>State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected</i>	120	We recommended the Legislature amend the parameters and guidelines through legislation to more clearly define activities that are reimbursable and to ensure that those activities reflect what the Legislature intended. The guidelines should clearly delineate between activities that are required under prior law and those that are required under the mandate.
<b>2002-104, California's Charter Schools:</b> <i>Oversight at All Levels Could Be Stronger to Ensure Charter Schools' Accountability</i>	147	To ensure that the chartering entities hold their charter schools accountable through oversight, the Legislature should consider amending the statute to make the chartering entities' oversight role and responsibilities explicit.
	150	In addition, to ensure that the chartering entities charge their oversight fees appropriately, the Legislature should consider clarifying the law to define the types of charter school revenues that are subject to the chartering entities' oversight fees.
	154	Finally, to ensure that a charter school's assets and liabilities are disposed of properly when it closes or its charter is revoked, the Legislature may wish to consider establishing a method for disposing of the school's assets and liabilities and requiring the California Department of Education to adopt regulations regarding this process.
<b>Energy, Utilities, and Communication</b>		
<b>2000-134.2, Energy Deregulation:</b> <i>The State's Energy Balance Remains Uncertain but Could Improve With Changes to Its Energy Programs and Generation and Transmission Siting</i>	169	<p>We recommended that the Legislature:</p> <ul style="list-style-type: none"> <li>• Create an expedited electricity transmission siting process for projects that are needed for short-term transmission system reliability.</li> <li>• Institute a coordinated electricity transmission siting process as it relates to other agencies similar to the coordinated power plant siting process used at the energy commission.</li> </ul>
<b>2001-118, California Energy Commission:</b> <i>Although External Factors Have Caused Delays in Its Approval of Sites, Its Application Process Is Reasonable</i>	173	The Legislature should consider establishing a firm 180-day deadline for intervenors to raise issues and submit data requests.

Report Number and Title	Page	Recommendation
<b>2001-009, California Energy Markets: Pressures Have Eased, but Cost Risks Remain</b>	188	We recommended that the Legislature and governor consider developing a comprehensive, long-term strategic framework for the electricity industry in the State and for the Department of Water Resources' (department) role in that system. We also recommended that the Legislature consider extending the department's purchasing authority to allow time for the development and implementation of a strategic framework and to assure continuity of the purchasing authority and an effective transition, presumably back to the investor-owned utilities.
<b>Health and Human Services</b>		
<b>2001-126, Department of Managed Health Care: Assessments for Specialized and Full-Service HMOs Do Not Reflect Its Workload and Have Disparate Financial Impacts</b>	256	We recommended that the Legislature consider changing the Department of Managed Health Care's (department) assessment structure to reflect the proportion of the documented workload that the department devotes to specialized and full-service health maintenance organizations (HMOs) and to reduce disparities in the financial effect on HMOs. We also recommended that the Legislature require the department to report to it triennially on the proportion of assessments charged to each class of HMO and the proportion of the documented workload related to each class of HMO.
<b>2001-015, Statewide Fingerprint Imaging System: The State Must Weigh Factors Other Than Need and Cost-Effectiveness When Determining Future Funding for the System</b>	280	The Legislature should consider the pros and cons of repealing state law requiring fingerprint imaging, including whether the Statewide Fingerprint Imaging System (SFIS) is consistent with the State's community outreach and education campaign efforts for the Food Stamp program. To assist the Legislature in its consideration of the pros and cons of repealing state law requiring fingerprint imaging, Social Services and the data center should report on the full costs associated with discontinuing SFIS.
<b>Insurance</b>		
<b>2001-126, Department of Managed Health Care: Assessments for Specialized and Full-Service HMOs Do Not Reflect Its Workload and Have Disparate Financial Impacts</b>		This audit is also included in the Health and Human Services policy area. See that policy area for the wording of our recommendation.
<b>Jobs, Economic Development, and the Economy</b>		
<b>2001-115, Technology, Trade and Commerce Agency: Its Strategic Planning Is Fragmented and Incomplete, and Its International Division Needs to Better Coordinate With Other Entities, but Its Economic Development Division Customers Generally Are Satisfied</b>		This audit is also included in the Banking, Finance, Commerce, and International Trade policy area. See that policy area for the wording of our recommendation.
<b>Local Government</b>		
<b>2000-016, Water Replenishment District of Southern California: Although the District Has Eliminated Excessive Water Rates, It Has Depleted Its Reserve Funds and Needs to Further Improve Its Administrative Practices</b>	332	We recommended, if restrictions on increasing assessment rates are extended past December 31, 2002, the Water Replenishment District of Southern California (district) should consider seeking legislative approval of statutory changes that will increase its flexibility to raise funds for its operations, capital improvement projects, and reserves.
	335	In addition, we recommended that the district continue to create an updated strategic plan and capital improvement plan to identify the programs and capital improvement projects that will aid it in fulfilling its mission.

Report Number and Title	Page	Recommendation
<b>Natural Resources, Parks, and Wildlife</b>		
<b>2000-117, The State's Real Property Assets:</b> <i>The State Has Identified Surplus Real Property, but Some of Its Property Management Processes Are Ineffective</i>		This audit is also included in the Business and Professions policy area. See that policy area for the wording of our recommendation.
<b>2000-134.2, Energy Deregulation:</b> <i>The State's Energy Balance Remains Uncertain but Could Improve With Changes to Its Energy Programs and Generation and Transmission Siting</i>		This audit is also included in the Energy, Utilities, and Communication policy area. See that policy area for the wording of our recommendation.
<b>2001-118, California Energy Commission:</b> <i>Although External Factors Have Caused Delays in Its Approval of Sites, Its Application Process Is Reasonable</i>		This audit is also included in the Energy, Utilities, and Communication policy area. See that policy area for the wording of our recommendation.
<b>2001-009, California Energy Markets:</b> <i>Pressures Have Eased, but Cost Risks Remain</i>		This audit is also included in the Energy, Utilities, and Communication policy area. See that policy area for the wording of our recommendation.
<b>2000-016, Water Replenishment District of Southern California:</b> <i>Although the District Has Eliminated Excessive Water Rates, It Has Depleted Its Reserve Funds and Needs to Further Improve Its Administrative Practices</i>		This audit is also included in the Local Government policy area. See that policy area for the wording of our recommendation.
<b>Transportation</b>		
<b>2001-103, Department of Motor Vehicles:</b> <i>Although Unable to Measure the Extent of Identity Fraud and the Effect of Recent Reforms, It Should Improve Its Technology, Procedures, and Staffing Further</i>	356	We recommended that the Legislature should reconsider funding to support an upgrade of Department of Motor Vehicles' (Motor Vehicles) finger-imaging technology if recent reforms to the process for issuing driver licenses and ID cards prove insufficient. If it provides the funds, the Legislature should consider protecting against unauthorized dissemination of finger images by allowing only those entities it believes have a legitimate interest in protecting the public, such as state and local law enforcement agencies, to access Motor Vehicles' finger-imaging data. The Legislature should also consider imposing criminal sanctions for unauthorized use of the data. Further, if the Legislature approves the use of finger imaging, it should consider directing Motor Vehicles to establish controls that protect the privacy of California citizens.
<b>2001-120, School Bus Safety II:</b> <i>State Law Intended to Make School Bus Transportation Safer Is Costing More Than Expected</i>		This audit is also included in the Education policy area. See that policy area for the wording of our recommendation.
<b>2001-125, Red Light Camera Programs:</b> <i>Although They Have Contributed to a Reduction in Accidents, Operational Weaknesses Exist at the Local Level</i>	368	We recommended that to ensure local governments maintain control and operate their red light camera programs and avoid legal challenge, the Legislature should consider clarifying the law to define the tasks that a local government must perform to operate a red light camera program and the tasks that can be delegated to a vendor.
	371	Because a potential conflict exists between the confidentiality provision in the Vehicle Code and the California Constitution regarding the admissibility of evidence, the Legislature should consider clarifying the Vehicle Code to state whether photographs taken by red light cameras can be used for other law enforcement purposes.

Report Number and Title	Page	Recommendation
<b>2002-103, Department of Transportation:</b> <i>It Manages the State Highway Operation and Protection Program Adequately, but it Can Make Improvements</i>	379	To ensure that the California Department of Transportation (Caltrans) can collect on a performance bond if a contractor does not perform, we recommended that the Legislature consider expanding Caltrans' ability to use other financial indicators included within the financial statements and information available from rating companies such as A.M. Best Company and S&P as a basis for determining the sufficiency of an insurer, before accepting performance bonds. Further, the Legislature should clarify Caltrans' authority to use the information it obtains from financial statements and other financial indicators to object to the sufficiency of an insurer throughout the bond term.
<b>Veterans Affairs</b>		
<b>2001-113, Department of Veterans Affairs:</b> <i>Weak Management and Poor Internal Controls Have Prevented the Department From Establishing an Effective Cash Collection System</i>	390	If the Legislature believes that the intent of its legislation creating the position of inspector general is not being met, it should consider clarifying state law governing the inspector general so that the inspector general has appropriate access to all department records.
<b>2001-127, Disabled Veteran Business Enterprise Program:</b> <i>Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success</i>	399	To determine if the 3 percent Disabled Veteran Business Enterprise (DVBE) goal is reasonable, the Legislature may wish to consider requiring either Department of General Services (General Services) or Department of Veterans Affairs to commission a study on the potential number of DVBE-eligible firms in the State, the services they provide, and their geographic distribution, and compare this information to the State's contracting needs. Based on the results of this study, the Legislature may wish to consider doing the following: <ul style="list-style-type: none"> <li>• Modify the current DVBE participation goal.</li> <li>• Allow General Services to negotiate department-specific goals based on individual contracting needs and the ability of the current or potential DVBE pool to satisfy those needs.</li> </ul>
	402	Also, to ensure that prime contractors make a genuine good-faith effort to find a DVBE, we recommended the Legislature consider requiring awarding departments to follow General Services' policies:
	403	Finally, to increase the efficiency and effectiveness of the DVBE program, we recommended the Legislature consider doing the following: <ul style="list-style-type: none"> <li>• Replace the current good-faith step requiring bidders to contact the federal government with a step directing bidders to contact General Services for a list of certified DVBEs.</li> <li>• Enact a contracting preference for DVBEs similar to the one for the small business program—that is, allow an artificial downward adjustment to the bids from contractors that plan to use a DVBE to make the bids more competitive.</li> <li>• Require awarding departments to go through their own good-faith effort in seeking DVBE contractors.</li> <li>• Provide awarding departments with the authority to withhold a portion of the payments due to contractors when they fail to use DVBEs to the extent specified in their contracts.</li> </ul>



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