

California State Auditor

B U R E A U O F S T A T E A U D I T S

California Veterans Board:

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



June 2003
2002-120

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CALIFORNIA STATE AUDITOR

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June 26, 2003

2002-120

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

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits (bureau) presents its audit report concerning the California Veterans Board's (board) oversight and guidance of the Department of Veterans Affairs (department) and the department's corrective actions resulting from the bureau's previous audit reports.

This report concludes that even though the board has been in existence since 1946, this seven-member volunteer board has not established itself as an effective policy-maker for the department. Further, the board lacks independent counsel to minimize the legal risks of its responsibilities for making policy and ruling on veterans' appeals of services the department has denied. In addition, the board's appeal process needs improvement to ensure that veterans' appeals are handled consistently and appropriately. The board's effectiveness is also hindered by its reduced membership and the lack of board member training on their responsibilities. Finally, our follow-up on certain recommendations we made to the department in two recent audits revealed that the department has implemented eight of the 14 recommendations, but has not given sufficient attention to a key recommendation regarding the long-term viability of the Cal-Vet program.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

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***California State Auditor's
Comments on the Response
From the Department of
Veterans Affairs***

SUMMARY

Audit Highlights . . .

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

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

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

RESULTS IN BRIEF

Established in 1921, the Department of Veterans Affairs (department) provides the State's veterans with low-cost home and farm loans, assistance in obtaining veterans' benefits, and various levels of care at three residential facilities. To set policy for the department and to offer veterans a forum to appeal department decisions denying services, the Legislature established the California Veterans Board (board) in 1946. State statutes give it broad policy-making authority over the department. Nonetheless, the board of seven volunteers has established itself as an ineffective policy-maker, unable to strengthen weaknesses in the department's administration of veterans' programs that the Bureau of State Audits (bureau) has reported over the past three years. As an example of the board's inability to effect strong policy, only half of its 32 policies provide direction for departmental operations. Further, although the bureau and other oversight agencies have identified a number of problems within the department, the board has no clearly defined policies to guide and monitor the department's corrective actions. The board also has not used the services of the inspector general for veterans affairs (inspector general) to review the department's operations in areas where board policy could improve the department's delivery of services to veterans.

Despite the board's important responsibilities for making policy and ruling on veterans' appeals of services that the department has denied, the board does not have an independent counsel to minimize the legal risks of its actions in these two areas. Instead, the board depends on the department's legal staff for advice on laws governing veterans' care—laws that the board must carefully consider when deciding on policy that affects the services delivered to veterans. The department's legal staff are likely well versed in these laws. However, because the board's policies govern the department, it is inappropriate for the department's legal staff to advise the board on policies under consideration. Further, the board's rulings on veterans' appeals should be based on independent and fair considerations of the department's actions and the veterans' rights to services. Currently, the board must rely on the department's legal staff for advice on appeals and to preside over appeal hearings—practices that introduce questions of fairness

and impartiality on appeal decisions. In addition, the lack of independent legal counsel has delayed the board's current policy revisions. Because the board has not adopted a policy demonstrating the need and desire to have independent legal counsel, it has been unable to obtain these services.

The board's current appeal process also needs improvement. An informal process loosely guides board members through appeal reviews and offers little assurance that veterans' appeals are handled consistently and appropriately. Further, the board does not have a clear understanding of the type of appeal procedures it should follow, which could result in the board conducting a more formal hearing on an appeal than is warranted or not giving veterans an adequate degree of protection.

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

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

The board's weak policy-making deprives a problem-prone department of needed assistance in improving on weaknesses documented in reviews by the bureau and other oversight agencies. Our follow-up on recommendations we made to the department in two recent audits revealed that the department has implemented eight of the 14 recommendations we could reasonably expect the board to address. However, it has not given sufficient attention to a key recommendation regarding the long-term viability of the Cal-Vet program, the department's loan program that helps veterans purchase farms or homes. As

mentioned in our previous audits, unless there is a change in federal tax laws, fewer and fewer veterans will benefit from the Cal-Vet program because federal tax restrictions have limited eligibility for loans backed by the bonds that supply the majority of the program's funding. We also estimated that the number of veterans eligible for these loans would shrink by 90 percent by 2010. Despite two previous unsuccessful efforts, the department is attempting to change federal tax laws to make more veterans eligible for funds for the Cal-Vet program. However, the department has not performed sufficient contingency planning for the potential reduction in the Cal-Vet program's funding should its efforts to change federal tax laws fail again. In response to our inquiries, the department created a high-level funding plan that summarized the options it might consider given the declining number of eligible veterans for the Cal-Vet program. However, the plan does not contain enough detail to sufficiently prepare the department for the potential loss of its largest funding source for the Cal-Vet program.

RECOMMENDATIONS

The board should make the following changes to ensure that it is an effective policy-maker as envisioned by the Legislature:

- Assert its policy-making authority by actively identifying areas of the department's operations that it feels need guidance or direction and developing meaningful policies that provide the department with the guiding principles necessary to complete its mission. Using the issues raised in our past audits and by the inspector general would be a good start for the development of specific policies. Further, using the services of the inspector general to conduct departmental reviews could also identify areas where new policies are needed.
- Monitor the corrective actions of the department regarding audit findings and recommendations. To this end, the board should establish a policy requiring the department to regularly report its progress in implementing corrective actions in response to external reviews and when needed, create policies to guide the department's corrective actions.

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

review veterans' appeals of services that the department has denied, the board should create a policy establishing formal written procedures for conducting appeals.

To ensure that every veteran's appeal is heard in the proper forum, the board should acquire the expertise to determine the appropriate type of hearing for each appeal. In addition, to avoid the appearance of bias in its appeal decisions, the board should discontinue relying on the department's attorneys for legal assistance and having the department's chief counsel preside over formal hearings.

To assist the governor in promptly appointing members to fill both current and future board vacancies, the board should consider proactively identifying possible board members when vacancies occur.

To enable board members to perform their policy-making and oversight functions effectively, the board should provide training to its members on the laws and regulations controlling veterans' affairs; board policies, duties, and authority, including how to conduct appeals; departmental operations; state laws regarding open meetings; and state laws regarding the privacy of medical information.

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

AGENCY COMMENTS

The board agrees with our recommendations and provided the actions that it plans to take. The department disagrees with our recommendation that the board obtain independent legal counsel, but generally concurs with the status we provide of the department's actions to implement certain recommendations from two of our previous audits. ■

INTRODUCTION

BACKGROUND

In 1946, the California Legislature established the California Veterans Board (board). As authorized by the Military and Veterans Code, the board determines the policies for all operations of the Department of Veterans Affairs (department). In addition, the board is responsible for hearing the appeals of veterans for whom the department has denied services and approving interest rate changes for the department's Cal-Vet program, which assists veterans in purchasing farms or homes. The board has also defined its mission to include ensuring that California veterans—who it indicates number more than 2.6 million—and their dependents are treated fairly and are given access to all available information about benefits authorized by state law, including quality residential facilities for veterans. Finally, the board interfaces with state veterans' organizations to share the governor's veteran-related public policy positions with the veterans living in California and to inform the governor of

veterans' viewpoints and concerns. The law requires the board to report its activities, accomplishments, and expenditures to the Legislature by October 1 of each year.

By statute, the board is to have seven members, all veterans, appointed by the governor and confirmed by the state Senate. Members volunteer their time on the board and serve four-year terms, except for the member residing at one of the Veterans Homes of California (Veterans Homes), who serves for two years. The state law on board membership and composition has changed five times beginning in 1996, with the most recent change made in September 2002. These changes define the types of expertise the Legislature expects from veterans sitting on the board; the current requirements are listed in the accompanying text box. The board-selected chairperson leads the board through its business. As shown in Figure 1 on the following page, the board created nine

select committees to facilitate its ability to conduct normal board business. With one or two board members on its staff, each select committee analyzes specific issues on behalf of the board and recommends actions for the board to approve.

Veterans Board Composition Requirements

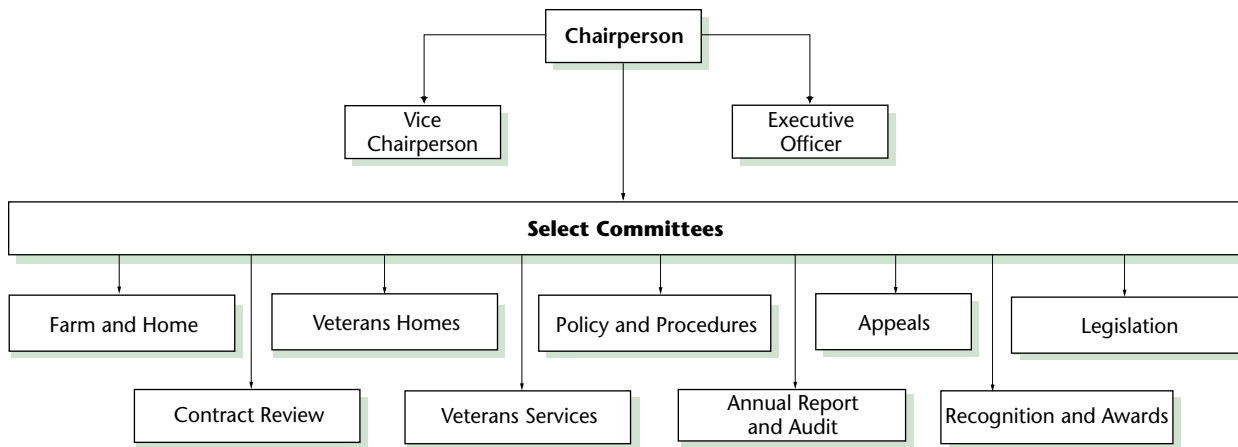
All seven members must be veterans, five of whom must meet the following requirements:

- One member must be a resident of one of the Veterans Homes of California.
- One member must have substantial training or expertise in mortgage lending and real estate finance.
- One member must have substantial training or expertise in geriatrics, gerontology, or long-term care.
- One member must have an accounting or auditing background and preferably be a certified public accountant.
- One member must be a career (service of 20 years or more) military retiree.

The board can create advisory committees, consisting of veterans who are not members of the department or board, to advise the board in various fields under or relating to the jurisdiction of the board. The board currently has one advisory committee—the POW (Prisoner of War) Advisory Committee.

FIGURE 1

**California Veterans Board
2003 Organizational Chart and Select Committees**



Source: California Veterans Board organization chart as of April 2003.

Board members do not receive salaries for their time on board business. However, members have their travel paid and receive per diem for attending board meetings and when conducting other board business. By state law, the board’s executive officer is a full-time state employee responsible for assisting the board by scheduling board meetings, recording all its proceedings, acting as a liaison with the department, processing veterans’ appeals of services denied by the department, and administering the board’s affairs between meetings. For fiscal year 2001–02, the board reports its expenditures were about \$151,000, mainly for travel costs and the executive officer’s salary.

The department has agency status, which means the department’s chief executive, whose title is secretary, reports directly to the governor. However, under the Military and Veterans Code, the secretary is subject to the policies of the board.

Board meetings occur one day a month for 10 months of the year at various locations in California. During board meetings, the board receives reports from the select committees, hears presentations by department staff on operational and fiscal issues, receives a report from the inspector general for veterans affairs, hears public comment, and considers any other issues placed on the agenda. Another important activity of the board during its meetings is hearing and ruling on appeals made by veterans for whom the department has denied services such as home loans, college fee waivers, or admission to one of the Veterans Homes. A veteran who is denied services or benefits first appeals to the head of the departmental division that issued the denial. If the division head denies the appeal, the veteran may then appeal to the board by requesting one of three levels of review: a review of the record, an informal hearing, or a formal hearing. The board chairperson initially assigns the appeal to one of the board members to review, and that member makes a recommendation to the board to either overturn the department's decision or reject the appeal. The board reviews the department's and the veteran's positions and then rules on the appeal. During 2002, the board received 22 appeals and overturned the department's decision on three of them.

SERVICES THE DEPARTMENT OFFERS VETERANS

The department was established in 1921 to provide California's veterans with a number of services and benefits through three main programs. The department's Cal-Vet program offers veterans low-cost loans to purchase farms or homes. The Veterans Services program, through County Veterans Services offices, focuses on helping veterans and their families obtain benefits to which they are entitled as a result of military service. These benefits include college fee waivers, disability compensation, health care, and vocational rehabilitation. The department's third main program is the Veterans Homes, comprising three residential facilities in Yountville, Barstow, and Chula Vista. At the Veterans Homes, eligible veterans receive medical care, social rehabilitation services, and residential services at five levels: domiciliary residential, licensed residential, intermediate nursing, skilled nursing, and acute or intensive care. As of May 2003, approximately 1,600 veterans lived in the three Veterans Homes. In 2002, the Legislature approved the construction of five new facilities in Fresno County, Lancaster, Redding, Saticoy, and

West Los Angeles. Three Veterans Homes are scheduled for construction starting in 2004, with full operation planned for 2006. The federal government has not yet committed the funding for the other two facilities.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to review the board’s oversight of the department. Specifically, the audit committee was concerned that the board may not always exercise independent oversight and guidance of the department in a manner that would further the department’s mission and goals. Additionally, the audit committee wanted to know the effectiveness of corrective actions the department has taken on the bureau’s recommendations from previous audits. Table 1 lists three audit reports the bureau has issued since May 2000 that address certain aspects of the department’s operations. In these reports, we made numerous recommendations to the department to correct deficiencies that we found in departmental operations.

TABLE 1

Bureau of State Audits’ Reports on the Department of Veterans Affairs Since May 2000

Audit Number	Issue Date	Audit Title
99139	May 2000	<i>California Department of Veterans Affairs: Changing Demographics and Limited Funding Threaten the Long-Term Viability of the Cal-Vet Program While High Program Costs Drain Current Funding</i>
2000-132	March 2001	<i>California Department of Veterans Affairs: Its Life and Disability Insurance Program, Financially Weakened by Past Neglect, Offers Reduced Insurance Benefits to Veterans and Faces an Uncertain Future</i>
2001-113	December 2001	<i>Department of Veterans Affairs: Weak Management and Poor Internal Controls Have Prevented the Department From Establishing an Effective Cash Collection System</i>

Note: We also conducted two other veterans-related audits since 2000; one concerned county-based programs and the other concerned the process of awarding state contracts to disabled veteran-owned firms.

To determine whether the board has been independently overseeing the department through policies, we reviewed the applicable laws and regulations as well as the board’s policies. We also observed several board meetings, reviewed the minutes and tape recordings of other board meetings, and interviewed the five members of the current board. To determine whether

the board's structure and level of resources allow it to adequately perform its mission, we reviewed board membership, training, attendance, and the resources available to assist the board. To determine whether the board has been developing independent conclusions regarding veterans' appeals of denied services, we reviewed the process the board members use to understand a veteran's case, including the criteria the board uses to render its decision. In addition, our legal counsel reviewed the board's appeal process to determine whether it is consistent with the requirements of state and federal law. We then tested a sample of appeals to verify that the board followed its process and criteria. We also reviewed the department's outreach efforts for the appeal process and found it to be adequate.

To determine the extent to which the department has implemented recommendations from our three previous audits, we selected key recommendations for review. However, we did not review recommendations from our December 2001 report because the Department of Finance (Finance) indicates that it is following up on all findings from that report. Finance expects to finish its work in July 2003. Thus, our follow-up on the department's corrective actions focused on our May 2000 and March 2001 reports. From the 25 recommendations in these reports, we chose to review the 14 recommendations related to areas in which we could reasonably expect the board to monitor the department's corrective actions. For the selected recommendations, we limited our review procedures to asking the department staff to explain the steps taken to implement our recommendations and reviewing documents the department provided. We then assessed the degree to which the department has implemented our recommendations. ■

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AUDIT RESULTS

THE CALIFORNIA VETERANS BOARD IS NOT AN EFFECTIVE POLICY-MAKER FOR THE DEPARTMENT OF VETERANS AFFAIRS

Although the law establishing the California Veterans Board (board) gives it broad policy-making authority over the Department of Veterans Affairs (department), the board has not effectively exercised this authority. For example, only half of the board's 32 policies direct the department's operations. Moreover, the board has not created or revised policies to address problems that we and other oversight agencies have identified in the department's programs. Finally, the board has not used the services of the inspector general for veterans affairs (inspector general) to explore areas within the department that may need board policy.

The California Court of Appeals Definition of Policy-Making

"To make policy" is to establish the "general principles by which government is guided in its management of public affairs,..." (Black's Law Dict., [5th ed. 1979], p. 1041, col. 2.) More specifically, policy-making involves the creation of "[g]uidelines, goals, objectives, system, code, custom, plan of action, course of action, methodology, platform, approach, tenets, creed, beliefs, directions, scheme, habit, tactic, style, management, design, strategy, line, polity, proposal, protocol." (West's Legal Thesaurus/Dict., [1985], p. 583.)

Source: *State Board of Education v. Honig*, (1993) 13 Cal App. 4th 720; 765.

The Board Has Ample Authority to Set Policies for the Department

California law gives the board far-reaching authority as the policy-maker for the department's programs. *Policy-making* is defined in the text box at the left. If the board recognized the scope of this definition and the breadth of its statutory authority, it could produce more effective policy to improve a department that has had numerous documented problems. While the Legislature could have created the board to be only an advisory body, currently the Military and Veterans Code (code) requires the board to determine the policies for all departmental operations and stipulates that the secretary of the department (its chief executive) is subject to the policies adopted by the board. Our legal counsel interprets the statutory authority of the board to give it broad authority to set

policy that governs the department, while the department has the authority to implement these policies through administrative actions. Although the distinction between *policy* and *administration* is not always clear, *policy* generally refers to the goals or objectives of an agency, while *administration* refers to the specific day-to-day means of achieving those goals and objectives.

In addition, relevant case law from a dispute between the superintendent of public instruction (superintendent)—who is the director of the California Department of Education—and the State Board of Education addressed the question of whether the superintendent must follow the policies of the State Board of Education. The California Veterans Board and the State Board of Education are similar in that they are both established as policy-making bodies for their respective departments, and state law created both boards to work together with, rather than separate from, their departments. In its decision on this case, the state appeals court clearly indicated that the State Board of Education has authority over the Department of Education and that the Department of Education is subject to the State Board of Education's policies. Further, the court considered the relationship between the two entities similar to that of a board of directors and the corporation it oversees. Although the enabling statutes and the questions of this case may not perfectly address the California Veterans Board's authority over the Department of Veterans Affairs, our legal counsel concluded that the statutes provide ample authority for the board to assert policy over the department.

The Board Has Not Effectively Exercised Its Policy-Making Authority

Although state law gives the board considerable policy-making authority over the department, the actions of both the board and the department indicate that the board is not exercising that authority. Specifically, the policies that the board has created so far have not been as effective as they could be given the board's authority over the department. Three of the five current board members told us that they were unsure how far their authority over the department extends. Further, in reviewing minutes of board meetings, we determined that board members realize their policy-making authority has limits, but they do not seem to understand how these limits apply to developing policies for the department. For example, in the minutes of four board meetings dating from April 2002, we noticed that board members indicated they felt hampered in their ability to enact new or revised policies because of the board's lack of independent legal counsel to assist them in drafting the policies and identifying when a proposed policy or revision crosses the line between policy-making and day-to-day operations. We agree that as a policy-making body, the board should not direct the operation of the department in implementing a board policy, but the board does need to know the extent of its policy-making authority to be effective.

Three of the five current board members told us that they were unsure how far their authority over the department extends.

Considering that the board has been in existence for more than 50 years and given the department's problems, we would expect the board's policies to be more expansive.

Our review of the board's current policies found limited guidance for the department's operations, with only half the policies actually providing department programs with direction from the board. As shown in Table 2 on the following page, the board has 32 policies currently in place, 11 of which relate to the board's administration. Of the remaining 21 policies, five are restatements of, or are based on, a current law or regulation. Therefore, 16 of the 21 remaining policies appear to contain ideas identified and enacted by the board that do not address board administration. Considering that the board has been in existence for more than 50 years and given the department's problems, which we and other agencies have documented, we would expect the board's policies to be more expansive.

Despite Reported Problems in the Department's Operations, the Board Has Not Issued Policies to Guide the Department's Corrective Actions

The board has not developed policies to guide the department's efforts to correct weaknesses in the department's administration of veterans' services that we and other agencies have identified. Over the past three years, we have conducted three audits addressing two of the department's three main programs: its loan program to help veterans purchase farms or homes, called the Cal-Vet program, and its residential facilities, the Veterans Homes of California (Veterans Homes). However, the board has not created or revised policies to address these problem areas. Specifically, our December 2001 report identified many control weaknesses within the Veterans Homes, including the department's inability to promptly submit claims for reimbursement to third parties, such as Medicare or Medi-Cal, for medical services performed at the Veterans Homes. It would have been reasonable for the board to create a policy that set goals for submitting claims for reimbursement, but we have not been able to identify any policy action by the board nor any specific discussion of the subject after the release of our report.

Further, our May 2000 and March 2001 reports identified concerns regarding the long-term viability of the Cal-Vet program, and consequently the life and disability insurance program, because of the declining number of veterans eligible for the department's largest source of loan funds. As discussed later in this report, the department believes it can eventually cause a change to federal legislation to make more veterans eligible for the Cal-Vet program. However, the board has no policy to formally guide the department's planning for the program's long-term viability.

TABLE 2

Many of the Board's Policies Do Not Provide Guidance for the Department

Policy Name and Number	First Adopted	Revision/ Review Date	Board Administration	Reiterates or Based on Department Regulation or Law	Ideas Identified and Enacted by the Board	Currently Being Revised
General Policy						
A-1 General Policy Statement	10/26/73	5/29/98	✓			
A-2 Budgetary Matters	1/20/84	5/29/98	✓		✓	
A-3 Board Meeting Publicity	3/21/75	5/29/98	✓			
A-4 Appeals to the Board	2/8/80	5/29/98	✓	✓		
A-5 Reports on Pending Litigation and Legislation	9/17/82	12/07/02	✓			
A-6 Board Meeting Agenda Items	7/27/84	5/29/98	✓			
A-7 Contracts by the Department	4/11/80	7/15/00	✓		✓	
A-8 Board Travel	5/29/98	—	✓			
A-9 Committees	8/28/98	—	✓			
A-10 Unauthorized Public Comments by Board Members	4/15/00	—	✓			
A-11 Board Quorum and Voting Majority	5/12/00	—	✓	✓		✓
Farm and Home Purchases Division						
B-1 Interest Rates	10/28/94	5/29/98			✓	✓
B-2 Property Substitution	5/14/82	5/29/98			✓	✓
B-3 Cal-Vet Loan Priorities	4/27/73	5/29/98			✓	✓
B-4 Loan Refinancing for Wounded or Disabled	2/17/78	5/29/98			✓	✓
B-5 Fire and Hazard Insurance/Guaranteed Replacement Costs	2/1/93	4/23/98		✓		
B-6 Farm and Home Program Business Plans and Reports	8/28/98	—			✓	✓
B-7 Farm and Home Insurance Programs	8/28/98	—			✓	✓
B-8 To Allow Interest Rate Changes to Cal-Vet Loans	7/15/00	—			✓	✓
Veterans Homes						
C-1 Financial Status	11/15/68	5/29/98		✓		
C-2 Disqualifying Conditions	9/21/73	5/29/98			✓	
C-3 Substance Abuse Problems	11/15/68	5/29/98		✓		
C-4 Disciplinary Procedures	11/15/68	5/29/98			✓	
C-5 Medical Staff on Duty	1/28/55	5/29/98		✓		
C-6 Post Funds	2/25/83	5/29/98			✓	
C-7 Land Use	9/21/73	5/29/98			✓	✓
C-8 Burial Procedures	11/15/68	5/29/98			✓	
C-9 Perpetual Care and Maintenance of the Memorial Cemetery at the Veterans Home of California, Yountville	11/19/82	5/29/98			✓	
C-10 Veterans' Spouses—Admission	12/15/95	5/29/98		✓		
C-11 Interfacility Transfer	8/28/98	7/18/00			✓	
Veterans Services						
D-1 Revocation of Specific Powers of Attorney	1/1/75	5/29/98			✓	
Resolutions						
E-1 POW (Prisoner of War) Advisory Committee	11/21/86	5/29/98			✓	

Note: Some policies are included in multiple columns because they include language that meets the description for more than one column.

Another agency that has been critical of the department is the Department of Health Services (Health Services), which has not only voiced its criticism but has also acted against the department's administration of veterans' welfare at the Veterans Homes. In July 2000, for example, Health Services responded to the department's substandard level of care of residents in the Barstow Veterans Home by revoking the department's certification to bill for Medicaid services. The U.S. Department of Health and Human Services restored this certification in January 2002. The department estimates its decertification resulted in the loss of \$5.7 million in federal and state funds for the period between June 2000 and June 2001. However, we have not seen any policy action by the board to intervene on the important issue of substandard care at the Barstow facility.

The board has a weak policy in place to monitor the department's corrective actions to deficiencies identified by oversight agencies.

In addition, the board has effected weak policy to monitor the department's actions to correct deficiencies identified by oversight agencies. Given the problems at Veterans Homes documented in our past report and in reviews by other agencies, it is reasonable for the board to have a clearly defined policy for closely monitoring the department's corrective actions on these deficiencies. However, the board's policy only states that the board's audit committee is responsible for reviewing all internal and external audits, and even this limited guidance is not enforced. In our review of minutes from board meetings held between January 2000 and April 2003, we noted only one substantial discussion by the board in September 2002 concerning the department's actions resulting from audits that ended more than a year earlier. Unfortunately, this discussion did not include any proposed policy action by the board. With a policy requiring more detailed and frequent reporting of the department's corrective actions, the board would be in a better position to monitor the adequacy of the department's operational improvements and to identify areas that still need board policy to guide the department's actions.

The Board Is Not Using the Services of the Inspector General to Identify the Need for Policies

State law requires the inspector general to provide ongoing and independent advice to the board and to perform reviews or investigations of the department's operations and financial conditions at the board's request. However, the board has not taken advantage of this resource. The inspector general's services could be valuable in identifying areas where a board policy is needed to improve the department's delivery of services to veterans. However, the

board seems to prefer informal reviews because, according to the board's executive officer, the board chairperson believes the monthly reports by the inspector general and department staff adequately address the board's primary concerns and make specific requests to the inspector general unnecessary.

An example of the board not creating a potentially useful policy stems from a suggestion it received from the inspector general. At the September 2002 board meeting, the inspector general noted that the board's current policy on reviewing contracts could be strengthened. The board's current policy is to review and approve any Invitation for Bid (IFB) and Request for Proposal (RFP) valued at more than \$250,000. The inspector general expressed concern that the department could be executing many contracts that are not subject to the board's review because they did not go through the traditional IFB or RFP process. The inspector general suggested that the board consider amending its policy to require review of all contracts worth more than a certain amount rather than following the limits of existing board policy. Despite the inspector general's concern, we have not been able to identify any discussions regarding his suggestion in any subsequent meetings, nor have we seen any revisions to the policy. According to the board's executive officer, the board did not revise this policy because it believes contract status briefings during board meetings are sufficient. However, it would have been both reasonable and prudent for the board to at least discuss the inspector general's suggestion of a policy change at the board meeting and to record the board's reasoning for not making a policy change in the minutes.

The Department Appears to Be Challenging the Board's Authority

Several instances in 2003 suggest that the department is challenging the board's authority. These instances create the appearance that the board is not in a position of control and clearly indicate a need for the board to exert its authority over the department. For example, as noted later, despite the board's conclusion that it needs independent legal counsel, the department has declined to fund the service because of budgetary constraints. In February 2003, the department also attempted to characterize the board as an "advisory board," making the board subject to a January 2003 budget letter from the Department of Finance (Finance) restricting the number of meetings for an advisory board to one per year. A department attorney reached this conclusion because he believed that the code made the board primarily a planning board that sets policy for the

In February 2003, the department attempted to characterize the board as "advisory" to limit its meetings to only one annually.

department, that under the code the board does not have regularly scheduled meeting dates, it has no administrative or managerial authority, and that the board's appeal functions can be delegated to the department's undersecretary or deputy secretary. However, the board received an opinion from the Attorney General's Office that disagreed with the department attorney's conclusion. The Attorney General's Office concluded that because the board has substantial policy-making and adjudicatory responsibilities, it was not subject to Finance's budget letter. Finally, in another instance, the department's chief executive, whose title is secretary, sent a memorandum to department and board personnel in March 2003 restricting travel to cut expenses. The letter was sent under both the secretary's and the board chairperson's names. According to the board's executive officer, the board chairperson was aware of the secretary's desire to cut travel costs, but he had no advance knowledge of the memorandum. These instances create the appearance that the board is not in control and has not exerted its policy-making authority over the department.

THE BOARD HAS NO INDEPENDENT COUNSEL TO PROVIDE LEGAL ADVICE ON ITS RESPONSIBILITIES

Services the Board Wants to Obtain From an Independent Counsel

1. Advise and represent the board when it hears appeals from veterans for whom the department has denied services.
2. Provide the board legal opinions concerning the scope of the board's authority.
3. Provide legal counsel on evolving policies and procedures.
4. Represent board members in any litigation resulting from investigations or audits related to their board duties.
5. Decrease the perception of a conflict of interest between department and board decisions.
6. Provide legal opinions regarding informal or formal requests for the release of reports and work products.

Source: Letters dated April 25, 2002, and November 1, 2002, from the board to the Attorney General's Office.

Despite its important responsibilities for making policy and ruling on veterans' appeals of services, the board does not have the independent counsel it requires to minimize the legal risks of its actions. The board's policy decisions can affect the services delivered to veterans and therefore require careful consideration of laws governing veterans' care. Although they are probably knowledgeable on these laws, the department's legal staff are not the appropriate advisors for the board on policies under consideration because the board's policies govern the department. Further, the board's rulings on veterans' appeals should have an independent and fair consideration of the department's actions and the veterans' rights to services. Currently, the board must rely on the department's legal staff for advice on appeals, a practice that introduces questions of fairness and impartiality on appeal decisions.

In April 2002, the board determined that it should have an independent counsel, citing the need for services such as legal advice on veterans' appeals and on the board's authority (see the text box). The inspector general supported the board's need by documenting his concerns regarding their lack

of independent legal counsel in a memorandum to the board. Subsequently, in November 2002, the board submitted a letter to the Attorney General's Office requesting consent to obtain the services of an independent counsel for occasions when it needs to avoid potential conflicts of interest that could arise by using the department's legal staff. The Attorney General's Office agreed to provide the board the assistance of an attorney from the Department of Justice (Justice). The board subsequently worked with the department to draft the interagency agreement with Justice.

However, according to the board's executive officer, the department has declined to execute the \$17,900 six-month interagency agreement with Justice due to budgetary constraints. Based on the code and the State Board of Education lawsuit mentioned earlier, our legal counsel concluded that if the board creates a policy stating that it should have independent legal counsel, the department is legally obligated to take steps to adhere to that policy. Further, it would be unreasonable to assume that the Legislature would give the board policy-making authority over the department but allow the department to have control over the board's budget. In a similar circumstance, the California Court of Appeal found that the Department of Education should not only provide funding for the legal counsel of the State Board of Education but also, if necessary, either reduce its own staff to provide the funding or redirect funding from other areas.

The board has not created a formal policy that demonstrates its need and desire to have independent legal counsel.

At no time during this process did the board create a formal policy that demonstrated its need and desire to have independent legal counsel. Policy development is an important board function because policies formally state the goals and objectives that the board establishes for the department to implement. Because the secretary of the department, and therefore the department as a whole, is subject to these policies by statute, formal policies bind the department to act on the board's decisions. However, because no formal policy exists, according to the department's administrative services division chief, the department was able to place the responsibility on the board to identify a source of funds. Unfortunately, the board still has not formalized its need for the services of an independent counsel, which is ultimately affecting its ability to address policy changes and introduces questions of fairness regarding the board's decisions on veterans' appeals of services denied by the department.

Lacking Independent Legal Counsel, the Board Must Rely on the Department's Legal Staff for Advice on Veterans' Appeals

Requesting assistance from the department's legal staff is not a prudent practice when the board is expected to independently render decisions on veterans' appeals.

As a consequence of its inability to retain independent legal counsel, the board must seek advice on veterans' appeals from the department's legal staff. Our review of 10 appeals revealed that the board used the department's legal staff in five instances in which using the services of an independent counsel would have been more appropriate. Considering that veterans are making their appeals to the board regarding decisions made by the department, it is reasonable to expect the board to review the basis of the department's denials from a different point of view. Most appeal processes are designed to reexamine evidence from an unbiased perspective and include consideration of the appellant's legal rights. Thus, requesting assistance from department's legal staff is not a prudent practice when the board is expected to independently render decisions on veterans' appeals. We observed that the State Personnel Board, which hears appeals of state employee personnel actions, has access to independent counsel during its appeal reviews. By using independent legal counsel, the board could avoid the appearance of partiality that might arise from having to turn to the department's legal staff when it needs legal assistance on appeals.

For example, in October 2002, the board received a request for an informal appeal from a veteran denied admission to a Veterans Home and assigned the appeal to a board member. The assigned board member sought a legal opinion from one of the department's attorneys about the veteran's rights and options to ensure that the department had addressed those rights and options. However, the response the board member received from the department's attorney included an analysis and conclusions on much more than just the veteran's rights and options. The department's attorney restated the department's reason for denying the veteran's admission to the Veterans Home, implying that the board member should take the same position. In this case, the board introduced the question of fairness into its appeal review process by using the department's attorney and the type of advice he provided.

The board consulted with the department's legal staff in four other appeal cases we reviewed. For a December 2001 appeal, the board consulted with the department's chief counsel and other department staff regarding a denial of a college fee waiver. The chief counsel and staff told the board it should deny the appeal, and department staff provided the key wording for the board's

denial letter. For a September 2002 appeal, the board's executive officer sought legal advice from the department on whether a veteran could change his informal appeal to a formal appeal. In two other appeals, the board requested that the department's legal staff provide the proper legal wording for a letter dismissing a veteran's appeal and a letter to a veteran in response to his request to be reimbursed for legal fees incurred on his appeal. In these instances, the use of the department's legal staff could raise questions about the fairness of the appeal process.

The Lack of Independent Legal Counsel Affects the Board's Ability to Revise Its Policies

Without an independent counsel, the board has chosen to delay its current policy revisions. As noted in the text box on page 17, one reason the board wants an independent counsel is to provide legal advice on evolving policies. The board began its current attempt to revise its policies in April 2002 but has not adopted the majority of the revisions more than a year later. Over the subsequent months, the board considered revisions for all 32 of its policies. Although the board drafted revisions for the 10 policies it decided to revise, it has adopted only one of the revisions. According to the board, it has not completed the policy revisions because it has been waiting to obtain the services of an independent counsel to determine the legality of the policy changes. An effective policy-making body needs to be able to develop and revise policies in a reasonable period to ensure that its policy decisions are timely and relevant. Unfortunately, the board's lack of independent legal counsel hinders its ability to perform timely policy-making.

An effective policy-making body needs to be able to develop and revise policies in a reasonable period to ensure its policy decisions are timely and relevant.

THE BOARD LACKS FORMAL WRITTEN PROCEDURES FOR CONDUCTING APPEALS IN A FAIR AND CONSISTENT MANNER

Despite the board's existence since 1946, it has no formal written procedures outlining or detailing instructions for processing appeals at an operational level. Without a set of formalized procedures, the board cannot ensure that its members have the same understanding of how to conduct appeals, nor can it be certain that members' actions are consistent. However, to give veterans the fair treatment they deserve and expect, and to avoid legal risks, the board must be able to process all veterans' appeals consistently and professionally.

Requiring board members to follow more detailed guidelines when reviewing appeals would help ensure that each veteran's appeal is reviewed with the same level of scrutiny.

The only written documentation the board has on its appeal process is a one-page high-level description of the process. However, this description does not guide board members through the specific steps they should follow when reviewing appeals. As a result, we found that board members' methods or processes of reviewing appeals were inconsistent. In our review of 10 appeals, the board members initially assigned to review the appeals and make recommendations to the board approached their reviews of similar appeals differently, possibly resulting in the veterans' appeals receiving different levels of analysis. For example, four of the 10 appeals involved denials of admission to Veterans Homes, and for each appeal, the reviewing board member was given the written appeal and department's case file supporting its admission denial. In three of the four appeals, the board members felt that they also needed to interview staff from the Veterans Homes and review the veterans' medical records submitted by the department. However, for one of the four appeals, the board member reviewing the appeal used the written appeal, the department case file, and a departmental legal opinion as the basis for his recommendation. Requiring board members to follow more detailed guidelines on what sources of information they need to consider when reviewing appeals would help ensure that each veteran's appeal is reviewed with the same level of scrutiny. With formal appeal review guidelines in place, board members would be less likely to go beyond their duties in reviewing departmental decisions based on facts known to the department and more likely to perform an adequate review of relevant information.

THE BOARD'S METHODS OF CONDUCTING APPEALS REVEAL ITS LIMITED UNDERSTANDING OF THE PROCEDURES IT SHOULD FOLLOW

The way the board conducts appeal hearings does not demonstrate a clear understanding of the appropriate procedures to follow when considering appeals. State law allows veterans to appeal to the board when the department denies them benefits, and the board is required by state law to grant a hearing if the appellant requests one. Further, state law authorizes the board to delegate appeals of decisions concerning the Veterans' Farm and Home Purchase Act to the Office of Administrative Hearings to be conducted by administrative law judges pursuant to the California Administrative Procedures Act.

The California Administrative Procedures Act provides procedural protection to individuals when state agencies, such as the board, make decisions that affect their rights. A California Court of Appeal decision has determined that the California Administrative Procedures Act applies only when the statute at issue expressly states that it applies. In this case, the statute in question makes the California Administrative Procedures Act applicable to an appeal conducted under the Veterans' Farm and Home Purchase Act only when the appeal is delegated to the Office of Administrative Hearings. Consequently, the California Administrative Procedures Act would not apply to the hearings conducted by the board unless the board decided to make that act applicable to its actions. Any hearing procedure that it does adopt, however, must provide sufficient procedural protection to guarantee that the due process rights of the individuals whose interests it considers are protected. Because a board hearing could result in the denial of a government benefit and thus the impairment of a constitutionally protected "property interest," the board must provide sufficient procedural protections when it considers an appeal. Not all interests deserve the same degree of protection, but generally, the interests or governmental benefits that are central to exercising a person's rights as a citizen deserve the greatest degree of procedural protection.

Three Appeal Options Available to Veterans

- *Review of the record:* includes a review of all official files and all documents and papers submitted by the appellant without a personal appearance by or interview with the appellant.
- *Informal hearing:* is similar to a review of the record but includes an informal interview or meeting with the appellant.
- *Formal hearing:* goes one step beyond an informal hearing. It is recorded electronically with testimony taken under oath or affirmation. The appellant has the right to call witnesses, introduce exhibits, cross-examine opposing witnesses, and rebut adverse evidence.

Source: California Veterans Board.

The board has adopted a practice that calls for one of three types of hearings for appeals (see the accompanying text box). This policy allows the appellant to designate which of the three types of hearings he or she desires. However, the board should have a clear understanding of the appropriate type of hearing to offer in any given situation and should advise the appellant accordingly. By offering appellants the right to choose the type of hearing they receive, the board might conduct a more formal hearing than is necessary or may not be providing an adequate degree of protection to veterans.

In addition, when the board conducts a formal hearing, it relies on the department's chief counsel to oversee the hearing, including swearing in witnesses, advising the board on law and procedure, and making decisions on the admission of evidence. As a member of the department's management team who reports to the secretary and possibly a participant in the original decision

to deny benefits, the chief counsel is not in a position to do either action in an unbiased manner. Thus, the board exposes itself to the risk of having its appeal decisions challenged on the basis that veterans did not receive unbiased hearings. Having the chief counsel for the department act as the presiding officer when the board conducts formal hearings raises concerns about whether that presiding officer can act impartially and reinforces the board's need for independent legal counsel.

WITH A REDUCED MEMBERSHIP, THE BOARD MAY LACK THE EXPERTISE THE LEGISLATURE INTENDED AND MAY BE UNABLE TO HOLD MEETINGS

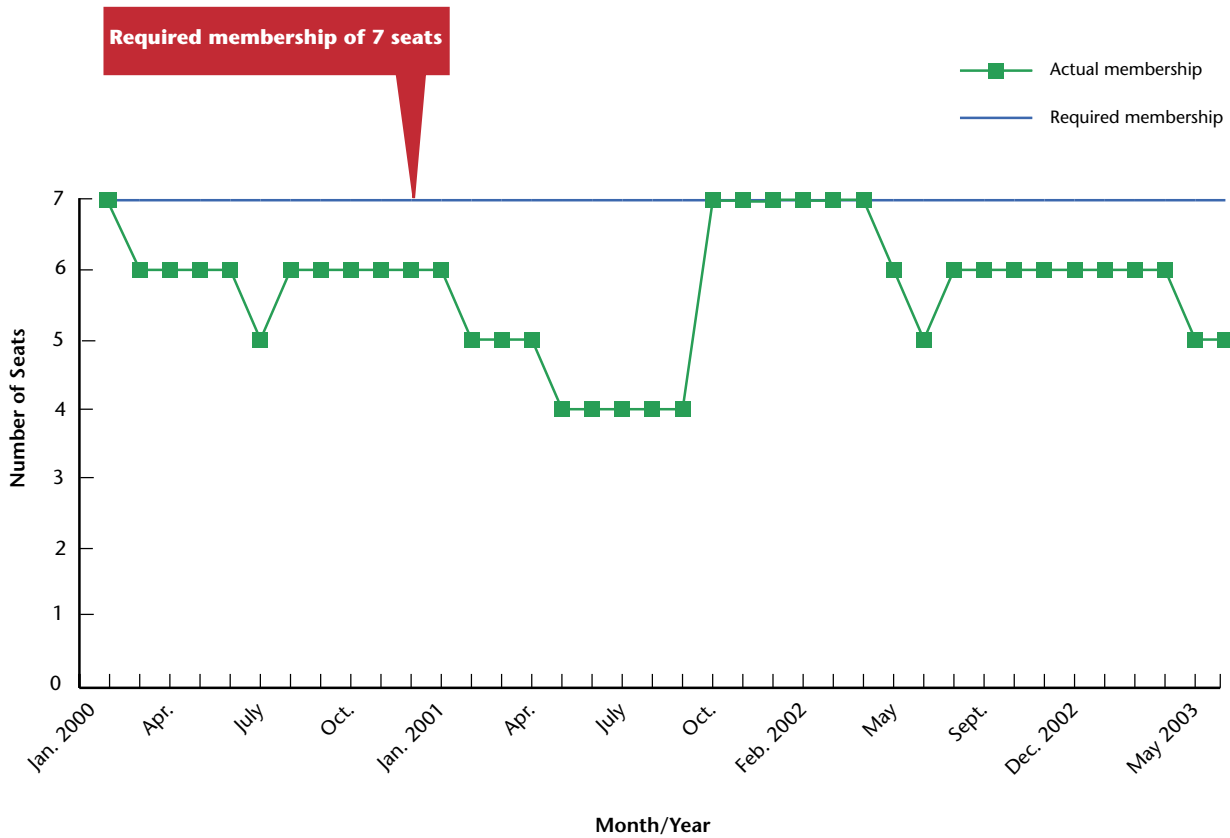
The Legislature's intent to fill the board with specific expertise is being thwarted by the board's diminished membership, which seldom reaches the seven members the law authorizes. The law states that the board's seven members must be appointed by the governor and be subject to state Senate confirmation. However, as Figure 2 on the following page shows, all board seats were rarely filled for the period from January 2000 through May 2003. Specifically, the board had a full membership only 18 percent of the time, or seven of the 38 months. Further, for 32 percent of the time, or 12 of the 38 months, the board had only four or five seats filled. The two current vacancies represent specialized expertise that current members may not be able to provide otherwise. The first vacant seat requires someone having accounting or auditing background, preferably a certified public accountant. The second vacant seat should be filled by a career military retiree.

For 12 of the 38 past months, the board had only four or five seats filled.

Having four or five members does not give the board much room to allow for absences, and given that board members are volunteers, a normal amount of absences can be expected. Operating at the level of four or five seats could also jeopardize the board's ability to conduct business when one or two members cannot attend a meeting. According to its policy, the board must have a quorum of four members to meet and conduct business. Since April 2003, the board has had only five members, one of whom recently had medical problems and is still recovering. If this member is unable to attend a future meeting because of health concerns, the board may only have its minimum level required for a quorum, providing no margin for another board member to miss a meeting.

FIGURE 2

**Board Membership
January 2000 Through May 2003**



Source: Minutes of the California Veterans Board meetings.

Note: The board did not meet in January 2002, June 2002, and January 2003, thus these months are not included in the figure.

The board has had difficulty obtaining a quorum in the past. According to its 1999 annual report, during the early months of 1999, the board had several vacancies and could not obtain a quorum. Consequently, the board was unable to hold meetings or conduct business for three months. In July 1999, when the board was able to meet again, there were 16 appeals waiting to be processed. Subsequently, the board continued to experience problems with vacancies. Specifically, in March 2000, the board held its select committee meetings and general meeting with only three members present. The board was careful not to decide on any matters during the two days it met and tabled approving previous minutes, taking positions on legislative bills, switching

future meeting locations, and approving department contracts. Consequently, the lack of a quorum for these meetings made the board less efficient than it could have been.

In May 2002 and April 2003, the board requested the governor to appoint two new members as soon as possible. The governor did appoint one new member in June 2002 to complete the last six months of the term of a member who resigned, but the seventh seat was never filled. Thus, the board again has two vacancies, and another board member is still ill and has been unable to attend a recent meeting. Despite the board often having one to three vacant seats from January 2000 to May 2003, it has not exerted much effort in recruiting new members because it maintains that the governor is responsible for filling vacant positions. Although the board is not required to nominate candidates for appointment, no laws prohibit the board from proactively recruiting new members.

TO BE AN EFFECTIVE OVERSIGHT AND POLICY-MAKING BODY, THE BOARD NEEDS TO ADEQUATELY TRAIN ITS MEMBERS

The board members do not receive training on laws and regulations controlling veterans' affairs; board policies, duties, and authority, including how to conduct appeals; departmental operations; state laws regarding open meetings; and state laws regarding the privacy of medical information.

Adequate training is a key factor contributing to the effectiveness of any governing body. However, board members, and the board's executive officer, lack the training they need to provide strong oversight to the department. Board members do fulfill their ethics training requirements, but they have not had training in other crucial areas. Specifically, the board does not provide its new members with training on laws and regulations controlling veterans' affairs; board policies, duties, and authority, including how to conduct appeals; departmental operations; state laws regarding open meetings; and state laws regarding the privacy of medical information. Moreover, according to the executive officer, the board does not have a plan or program to address the ongoing training needs of board members. This lack of training could have serious consequences and may have caused the board to violate state open-meeting laws by ruling on a veteran's appeal that was not on the meeting agenda and discussing confidential medical records in public meetings. Because the intent of the law is that the board be an independent policy-making body and provide oversight to the department, it is reasonable to expect board members to receive ongoing training on their responsibilities. Providing such training could improve the board's effectiveness and oversight.

Although one board member did ask the department to provide her with an orientation of its operations when she first joined the board, according to its executive officer, the board normally gives new members only copies of applicable state laws, board policies, and Robert's Rules of Order. The executive officer further stated that he attended a training session on state open-meeting laws in November 2002, but no board members attended this session. The executive officer stated that the board currently has no plan to train board members on the open-meeting laws, citing the difficulty of getting all board members together in one place at one time and the lack of available training courses. Further, he noted that there are no directives for training a volunteer board, but the board envisions that formal training on laws, regulations, and procedures would be developed with the aid of independent legal counsel. The chairperson has directed that a training plan be developed, but no timetable has been established.

Key Points of the State Open-Meeting Law

Enacted by the Legislature with the intent that actions and deliberations of state bodies be done openly. The law provides guidance for the meetings of state bodies, including the following:

- The definition of a state body.
- The definition of meetings that are governed by the state open-meeting law.
- The requirement that all meetings, except under certain conditions, be open to the public.
- The requirement to provide public notice of meetings and agendas of the business to be discussed or transacted.
- The circumstances allowing closed sessions.
- Other requirements and conditions governing the conduct of meetings by state bodies.

Source: The Bagley-Keene Act, contained in California Government Code, sections 11120 to 11132.

Lack of Board Training May Have Resulted in Violations of the State Open-Meeting Laws

Lack of training for board members may have resulted in potential violations of the state open-meeting laws by the board. For example, the board denied an appeal at its August 3, 2002, meeting when the appeal was not on the meeting agenda. According to state open-meeting laws, no item can be added to an agenda after the agenda is posted except under certain circumstances. Therefore, if an interested party were to take legal action against the board, the appeal denial could have been nullified by a determination that the board violated the open-meeting laws. Similarly, insufficient training may have contributed to the board's hearing of two formal appeals in public meetings that likely should have been heard in closed sessions, based on the state open-meeting laws and the state laws regarding the privacy of medical information. The board heard two formal appeals on denials of admission to a Veterans Home during public meetings in July and December of 2002. Because both hearings involved discussions of veterans' medical and psychiatric conditions, medical records, psychiatric evaluations, and military service records, the board should have conducted the hearings in closed sessions to protect confidential medical

information about veterans. State open-meeting laws allow the board to meet in closed session when conducting a hearing under the California Administrative Procedures Act, presumably to protect the confidentiality of matters discussed in those hearings. Although appeals considered by the board are not necessarily to be conducted under the California Administrative Procedures Act, our legal counsel has advised us that the same confidentiality concerns are at issue here, and the board should take the appropriate steps to ensure the confidentiality of the materials it reviews when hearing appeals. Moreover, state laws require that a person's medical information be safeguarded to ensure that person's confidentiality and privacy. In view of the important right to privacy, the board should take appropriate steps to ensure the confidentiality of these records. If board members had proper training, these potential violations of state open-meeting laws may have been avoided.

DESPITE IMPLEMENTING MANY RECOMMENDATIONS WE MADE IN PREVIOUS AUDITS, THE DEPARTMENT HAS NOT SUFFICIENTLY ADDRESSED AN IMPORTANT ISSUE FOR THE CAL-VET PROGRAM

Although the department has implemented many of the 14 recommendations we reviewed from two of our previous audits, it still has not sufficiently addressed some important concerns. Most noteworthy is the department's insufficient action on maintaining the viability of the Cal-Vet program, an issue we targeted in a May 2000 audit report. As shown in Table 3 on the following pages, based on the information the department provided us, the department has implemented eight of 14 recommendations. On five of the remaining six recommendations, the department has made some progress by taking corrective action.

The department has implemented eight of 14 recommendations, but needs to do more work to address the remaining six recommendations.

One effort the department made, together with the board, was implementing our recommendation to conduct a series of public meetings regarding the future of the life and disability insurance program. Through the life and disability insurance program, qualified veterans in the Cal-Vet program can obtain disability insurance, so that injury or illness will not stop them from making loan payments, and life insurance, so their surviving spouses can pay off some, or all, of their mortgages. In our March 2001 audit, we identified and described past changes to the life and disability insurance program that significantly altered the benefits the department offers veterans.

TABLE 3

**Status of Department Actions on Selected Recommendations From
Previous Bureau of State Audits Reports**

Report Number and Date	Recommendation and Status
99139 May 2000	<p>The department should determine how to best serve California veterans in acquiring farms and homes using the remaining limited funding for the Cal-Vet program. If the department decides to continue its present strategy of using available funds to provide loans at the lowest possible interest rates, it should plan its operations for future curtailment of new loan activity. If the department determines that veterans are best served with interest rates closer to market interest rates and expands its pool of funds with alternate financing methods, it should consider the following actions:</p> <p>Maintain current demographic data necessary to identify the population of veterans eligible for, and likely to participate in, the Cal-Vet program.</p> <p><i>Partially implemented:</i> The department acted on our recommendation by contracting with a company to provide current demographic information to sales marketing staff and field office managers. However, according to the department, this contract expired in October 2002 and some of its data is not current.</p>
	<p>Seek approval for an interest rate methodology to allow the Cal-Vet program to quickly adjust interest rates in accordance with changes to market rates.</p> <p><i>Implemented:</i> With the approval it received from the board and the Veterans' Finance Committee, the department now can make adjustments to loan interest rates in a week or two, rather than in months as it did in the past. The department has employed this methodology six times since it received the approval in March 2001.</p>
	<p>Explore methods of additional funding for loans, such as blending taxable bond proceeds with traditional tax-exempt bond proceeds.</p> <p><i>Partially implemented:</i> The department indicates that it continually assesses the economic and demand factors to determine other methods to increase program resources. Further, it indicates that the pool of unrestricted funds is exceptionally large now because prepayments of loans, which are the main source of unrestricted funds, have increased significantly. Because of the high prepayment activity and low loan demand for funds, the department does not believe it is necessary at this time to consider blending taxable bond proceeds with tax exempt bonds to increase funds for loans. Finally, the department states that it will continue to monitor funding needs and will revisit this issue at the appropriate time.</p>
	<p>Based on the above steps, adapt the Cal-Vet program to provide a home loan benefit to the greatest number of qualifying veterans for as long as possible.</p> <p><i>Partially implemented:</i> The department has followed the second course of action outlined in our recommendation, setting interest rates closer to market rates and implementing certain improvements to the Cal-Vet program. The department believes that it has sufficient funding from current sources due to high prepayment activity and low loan demand. Further, while it has done some work to explore alternative financing methods for future loans, the department's focus is to change federal tax laws governing Qualified Veterans Mortgage Bonds (QVMBs) backed loans. However, similar efforts by the department in 1997 and 1999 were unsuccessful. Therefore, the department should make contingency plans to find alternative funding or scale back the Cal-Vet program. In May 2003, the department prepared a high-level funding plan summarizing the options the department may consider given the projected declining number of eligible veterans for the QVMB component of the Cal-Vet program. However, the plan does not contain enough detail to sufficiently prepare the department for the potential loss of its largest funding source of the Cal-Vet program. Further, this plan does not contain any options for the life and disability insurance program, which will also suffer from the potential loss of the QVMB component of the Cal-Vet program.</p>

Report Number and Date	Recommendation and Status	
99139 <i>continued</i>	To further increase the efficiency and consistency in its operations, thereby reducing costs and improving loan processing times, the department should do the following:	
	Track industry standards and its own operations and develop and implement workload standards it can use in staffing and budgeting decisions for its field offices and headquarters offices.	<i>Not implemented:</i> The department cited budget constraints and lack of resources as the cause for failure to implement this recommendation. However, the department indicates it began studying workload standards in February 2003.
	Develop a field office staffing model appropriate for the Cal-Vet program's current loan volume.	<i>Implemented:</i> The department reports that it has revised its field office staffing model after centralizing loan processing and based on demographic needs, and that it makes adjustments to staffing as circumstances permit.
	To ensure that its integrated information system functions reliably, the department should convene a centralized implementation team, including a project manager and sponsor from the department's executive management team with the authority to allocate the necessary resources. Additionally, the department should contract with an outside consultant with experience in project management to oversee the team. The team should gather all data from prior implementation efforts, assess what tasks still remain incomplete, and identify the steps needed to properly test the module and systems. In addition, the team should obtain the training necessary to design the program performance reports and financial reports the department needs to efficiently and effectively operate the loan program. We also identified specific activities that this team could perform to help ensure that this system functions reliably.	<i>Implemented:</i> The department indicates that it has completed the work with its consultants and has instituted those changes identified to ensure that its integrated information system functions reliably.
2000-132 March 2001	The department should ensure that 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.	
		<i>Partially implemented:</i> The department contracted with an actuary to create a revised methodology. It is now currently using this methodology as the basis for determining its annual liabilities. However, the department also admits to not having the in-house expertise necessary to implement improvements to the methodology suggested by its actuary.
	When choosing its option for the future of the life and disability insurance program, the department should establish a long-term strategy for the program that does not adversely affect the financial health or marketability of the Cal-Vet program. Further, any long-term strategy that it develops should include the following: (1) the aging population of veterans in the Cal-Vet programs will likely increase the cost of premiums, (2) the uncertainty of future funding for loans to younger veterans, (3) the future cost of the life and disability insurance program beyond the five years any group insurance policy will cover, and (4) the discontinuance of the disability insurance program for veterans who entered the program after 1996 and who are not currently disabled.	<i>Partially implemented:</i> The department's current plan satisfies two of the four considerations mentioned in the recommendation. However, it does not consider the cost of the life and disability insurance program beyond the five years its group policy covers, nor does it adequately address the uncertainty of future funding for loans to younger veterans.

continued on the next page

Report Number and Date	Recommendation and Status
2000-132 <i>continued</i>	<p>The department should continue its efforts to loosen the federal income tax restrictions on the proceeds of QVMBs to make younger veterans eligible. Such additional funding for younger veterans will serve to lower the average age of veterans in the Cal-Vet program and the cost of providing life and disability insurance coverage.</p>
	<p><i>Implemented:</i> The department indicates that it is working with the four other states that also issue QVMBs, and these efforts have resulted in the introduction of bills into the U.S. House of Representatives and the U.S. Senate.</p>
	<p>To allow public comment and to give interested parties an opportunity to present ideas for improving the life and disability insurance program, the department, together with the board, should conduct a series of public meetings regarding the future of the life and disability insurance program. Then the department and the board should consider the public comments when identifying viable options for the program to best serve the veterans.</p>
	<p><i>Implemented:</i> Despite holding several meetings, the department reports that it and the board did not consider the public comments helpful for identifying viable options for the future of the life and disability insurance program.</p>
	<p>When identifying potential sources of funds for improved life and disability insurance benefits to veterans, the department should consider modest and appropriate premium rate increases.</p>
	<p><i>Implemented:</i> The department considered modest premium rate increases, but determined such increases are not necessary with its new insurance policy.</p>
	<p>Explore options for transferring unrestricted funds to the life and disability insurance program.</p>
	<p><i>Implemented:</i> Because transferring unrestricted funds to the life and disability insurance program would limit its ability to provide loans to recent veterans, the department reports it will not do so.</p>
	<p>Finish implementing the new cost allocation system to ensure proper costing to the Cal-Vet program. Identify savings to the Cal-Vet program and consider using those savings to improve the insurance program.</p>
	<p><i>Implemented:</i> To implement this recommendation, the department conducted four quarterly time studies. The department states it is finalizing the data from the fourth time study, which ended April 11, but the preliminary data indicate that the final cost allocation shift from the Veterans Homes Division to the Division of Farm and Home Purchases for the Cal-Vet program is estimated at \$600,000.</p>

Our recommendation was intended to allow public comment and to give interested parties an opportunity to present ideas for improving the life and disability insurance program. A special board meeting was held on April 19, 2002, to allow the public to voice opinions concerning the life and disability insurance program as well as the process of obtaining a new policy for the life and disability insurance program. Subsequently, the board discussed the life and disability insurance program in eight meetings before the effective date of the new policy. Unfortunately, the department does not believe that the public comments it received helped identify viable options for improving the life and disability insurance program.

One recommendation not implemented by the department was for it to track industry standards and its own operations and to develop and implement workload standards to use in staffing and budgeting decisions. The department stated it has not implemented the recommendation because of budget constraints but that it began studying workload standards again in February 2003.

The Department Has Not Sufficiently Addressed a Key Recommendation Regarding the Long-Term Viability of the Cal-Vet Program

The department has not sufficiently performed long-term contingency planning to address recommendations we made about the long-term viability of the Cal-Vet program. Under the Cal-Vet program, the department issues bonds to provide funds for the farm and home loans it makes to veterans. In our audit of May 2000, we expressed concern about the future viability of the Cal-Vet program due to the projected decrease in the number of veterans eligible for the Qualified Veterans Mortgage Bonds (QVMBs), the program's largest source of loan funds, and because of the diminishing amount currently available from its other two funding sources for loans. In the current decade, fewer and fewer veterans will benefit from the QVMBs because federal tax restrictions have limited the eligibility for loans backed by these bonds to a shrinking population of older veterans. Based on the average age of veterans meeting the requirements, we estimated in our May 2000 audit that the number of veterans eligible for these loans would drop by 90 percent by 2010. The Cal-Vet program also uses "unrestricted" funds, which are generated by both prepayments and repayments of certain veterans' loans, and by funds from Qualified Mortgage Bonds. Unfortunately, these two sources represent only 20 percent of the funds available in February 2003 for the Cal-Vet program and thus are insufficient to make up for the loss of QVMB funding.

We previously estimated that the number of veterans eligible for loans from the Cal-Vet program's largest funding source would drop by 90 percent by 2010.

Our May 2000 recommendation, shaped by our concern for the long-term viability of the Cal-Vet program, focused on encouraging the department to develop a strategy to best serve California veterans in acquiring farms or homes, given that eligible veterans for the QVMB loans funds are diminishing. We recommended that the department choose one of two courses of action. If the department decided to continue its present strategy to provide loans at the lowest possible interest rates, we

recommended it plan its operations for the future curtailment of new loan activity. In contrast, if the department decided to change its strategy to set loan rates closer to market interest rates and expand its pool of funds with alternative financing methods, we recommended several steps the department could take to extend some of the funding for the Cal-Vet program beyond the time we had projected.

The department has followed the second course of action, setting interest rates closer to market rates and implementing certain improvements to the Cal-Vet program. Moreover, it believes that it has sufficient funding from current sources due to high prepayment activity and low loan demand. Although it has explored some alternative financing methods for future loans, the department has focused on changing federal tax laws governing QVMB-backed loans. The department reports it is currently working with the four other states permitted to grant QVMB-backed loans to encourage Congress to change federal tax laws with the intent of increasing the number of veterans eligible for QVMB-backed loans. Similar efforts by the department in 1997 and 1999 were unsuccessful, and the outcome of the department's current effort is questionable. In fact, it appears that the original intent of Congress in creating the specific eligibility restrictions on the Cal-Vet program was that the program would eventually end. Given the past failures to change federal tax laws, the department should make contingency plans to find alternative funding or scale back the Cal-Vet program.

The department recently prepared a high-level funding plan, but the plan does not contain enough detail to sufficiently prepare the department for the potential loss of its largest funding source of the Cal-Vet program.

In response to our inquiries, the department prepared a high-level funding plan in May 2003 summarizing options the department might consider given the projected declining number of eligible veterans for the QVMB component of the Cal-Vet program. However, the plan does not contain enough detail to sufficiently prepare the department for the potential loss of its largest funding source for the Cal-Vet program. Further, this plan does not contain any options for the life and disability insurance program, which will also suffer from the potential loss of the QVMB component of the Cal-Vet program.

Insufficient Contingency Planning Also Affects the Department's Ability to Continue the Life and Disability Insurance Program

The department's insufficient contingency planning may also impact the department's life and disability insurance program. Currently, the department requires all veterans under age 62 who enter the Cal-Vet program to apply for life insurance, but it does not require them to apply for disability insurance. The life and disability insurance program's financial viability depends on the Cal-Vet program providing loans to younger veterans because their premium rates more than offset their expected cost of benefits. Although the department provided us with a funding plan in May 2003, the plan does not address the potential problems surrounding the declining number of veterans eligible for QVMB funding on the life and disability insurance program. Unless the department starts formulating contingency plans and long-term strategies to minimize the impact that losing QVMB funding might have on the life and disability insurance program and to counterbalance its aging insured population with younger veterans, it may not be able to offer those loans in sufficient numbers to keep the Cal-Vet program and the corresponding life and disability insurance program viable and available to future veterans.

The life and disability insurance program will face a shortage of funds because the rate at which younger veterans are entering the program will decline.

The rate at which younger veterans are entering the life and disability insurance program will decline because the department faces a shortage of loan funds typically available to younger veterans. In fact, our March 2001 audit revealed that, according to the department's consultant, within 12 to 15 years (now 10 to 13 years), the department will have to use its unrestricted funds to pay bond costs rather than to provide new loans. Unless the department can make more loans to younger veterans, the life and disability insurance program will suffer because the cost of insurance benefits to all veterans in the Cal-Vet program will continue to increase along with the ages of the participating veterans. Given the potential downsizing of the Cal-Vet program, as noted in the previous section, the life and disability insurance program will also likely lose much of its funding soon. The department's failure to plan for the loss of new members is shortsighted and jeopardizes the financial viability of the life and disability insurance program.

RECOMMENDATIONS

The board should make the following changes to ensure that it is an effective policy-maker envisioned by the Legislature:

- Assert its policy-making authority by actively identifying areas of the department's operations that it feels need guidance or direction and developing meaningful policies that provide the department with the guiding principles necessary to complete its mission. Using the issues raised in our past audits and by the inspector general would be a good start for the development of specific policies. Further, using the services of the inspector general to conduct departmental reviews could also identify areas where new policies are needed.
- Monitor the corrective actions of the department regarding audit findings and recommendations. To this end, the board should establish a policy requiring the department to regularly report its progress in implementing corrective actions in response to external reviews and when needed, create policies to guide the department's corrective actions.

To improve its ability to independently make decisions on policies and appeals, and to reduce the legal risk created by its present practices, the board should establish a policy to obtain the services of an independent counsel to assist with its policy-making and appeal responsibilities. To consistently and fairly review veterans' appeals of services that the department has denied, the board should create a policy establishing formal written procedures for conducting appeals.

To ensure that every veteran's appeal is heard in the proper forum, the board should acquire the expertise to determine the appropriate type of hearing for each appeal. In addition, to avoid the appearance of bias in its appeal decisions, the board should discontinue relying on the department's attorneys for legal assistance and having the department's chief counsel preside over formal hearings.

To assist the governor in promptly appointing members to fill both current and future board vacancies, the board should consider proactively identifying possible board members when vacancies occur.

To enable board members to perform their policy-making and oversight functions effectively, the board should provide training to its members on the laws and regulations controlling veterans' affairs; board policies, duties, and authority, including how to conduct appeals; departmental operations; state laws regarding open meetings; and state laws regarding the privacy of medical information.

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

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



ELAINE M. HOWLE
State Auditor

Date: June 26, 2003

Staff: John R. Baier, CPA, Project Manager
Phillip Burkholder, CPA
Susie Lackie, CPA
Sheryl Liu-Philo, CPA
Dawn Beyer
Adam Ludvigson

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Agency's comments provided as text only.

California Veterans Board
P.O. Box 942895
Sacramento, CA 94295-0001

June 17, 2003

Bureau of State Auditors
Ms. Elaine M. Howle
State Auditor
555 Capitol Mall, Suite 300
Sacramento, CA 95814

SUBJECT: California Veterans Board Response to Bureau of State Audits
Report dated June 11, 2003.

Dear Ms. Howle:

The California Veterans Board thanks you and your team for the professional review of the Board's mission, resources, procedures and accomplishments during the past several months of auditing. Your report is not only detailed but has many suggestions that the Board will act on to improve the service we provide to the Veterans of California. Your team members including: John Baier, Phillip Burkholder, Dawn Beyer, and Sheryl Liu-Philo were always very professional in their research and follow-up on topics of review. They listened to explanations and provided many positive suggestions to improve the management of the Board.

The Board replies to this California State Audit's Report are attached for consideration and enclosure in the final report. I would be delighted to answer questions or provide additional information. I can be reached through the Board's Executive Office at the phone number listed above.

Sincerely,

(Signed by: Earl Steck for)

George G. Sinopoli
Chairman
California Veterans Board

Enclosure

SUBJECT: Replies by the Californian Veterans Board Members (CVB) on Bureau State Audit (BSA) recommendation and comments: BSA Audit, 6/17/03.

1. The California Veterans Board should assert its policy-making authority by actively identifying areas of the department's operations that it feels need guidance or direction, and by developing meaningful policies that provide the department with the guiding principles necessary to complete its mission.

Reply: The California Veterans Board members are all volunteers, non-paid appointees donating their time to serve the veterans of California. In accordance with the California Veterans Code, the Board is the policy-making body of the Department of Veterans Affairs and the Secretary is subject to the policies adopted by the Board. With limited budget, restricted time and only one full time staff, the Board still accomplishes noteworthy results, as are recorded in the CVB annual reports. The Board believes any organization can improve its quality of service with time, resources, and clearly declared authority statements. With the rapid changes taking place in the veterans community, the CVB will develop action plans based on the suggestions provided in this report and focus on the current and future needs of California Veterans. The CVB will seek outside legal counsel to develop, revise and finalize areas identified here that strengthen the authority and resolve of the Board. The outside counsel will be tasked to review the documents presented in this report, then to assist the Board in formulating new policies for guidance to the Department of Veterans Affairs. This report has provided significant legal opinions to reinforce the Board's efforts to clarify responsibility and authority. The next step for the Board's authority will be to gain complete control of its budget as intended by recent legislation.

Plan of action: Use past BSA audits and the IG's annual report as starting points for revised policies.

2. The California Veterans Board should monitor the corrective actions of the department regarding audit findings and recommendations.

Reply: The Board has requested and the Department has presented updated reports at numerous Board meetings on the outcome of audits, investigations, and on-going reviews. The context of those reports included general status on actions being taken to correct what was identified as areas needing change. The details presented in this Audit report indicate a written policy would assist in guiding the Department toward more specific reports on the operational procedures used to correct the areas of concern. The major areas of concern listed in the past audits are from years 1999-2001. New leadership is now in place in all key positions in the Department of Veterans Affairs and positive actions are taking place to correct each of the stated concerns. Once the Board has access to the latest BSA audit report on the current review of these actions, then specific action plans can be developed to address the remaining areas of concern.

Plan of action: Establish policy requiring the department to regularly report its progress in implementing corrective actions. Use past BSA audits and past IG reports to guide the action plan.

3. The California Veterans Board should have an Independent Counsel to provide legal advice on its responsibilities.

Reply: The California Veterans Board will establish a policy for the independent counsel and require CDVA to find the resources to support. Once Independent Counsel is present, the California Veterans Board Members will use that resource for opinions on policy and appeals issues.

Plan of action: Establish a policy of having an Independent Counsel and fund accordingly. 1

SUBJECT: Replies by the Californian Veterans Board Members (CVB) on Bureau State Audit (BSA) recommendation and comments: BSA Audit, 6/17/03., continuation page.

4. The California Veterans Board should have formal written procedures for conducting appeals in a consistent manner.

Reply: The California Veterans Board members have conducted appeals in what was believed to be a “fair and consistent manner.” For the record, the California Veterans Board has never had an objection processed in civil court against a decision rendered. Due to the fact that the Board is the final administrative step in the appeal process, the Board agrees that a written procedure manual will formalize the process used by future California Veterans Board members for appeals.

Plan of action: Create a manual and include procedures for conducting all levels of appeals.

5. The California Veterans Board, with a diminished membership, may lack the expertise the Legislature intended and therefore, may be unable to hold meetings.

Reply: There is always the concern that meetings could be cancelled if some members were unable to attend, thereby lacking a quorum. As the Board stands today, there are two vacancies. Members of the California Veterans Board have provided nominations to the Governors Appointment Secretary for new members to fill these vacancies. The Chairman of the Board will provide an updated recommendation for the Governors consideration.

Plan of action: Board members will provide lists of other volunteers that may be appointed to serve on “CVB Advisory Committees” where specialized skills are required.

6. The California Veterans Board should adequately train its members in order to be an effective oversight and policy-making body.

Reply: Training is always a valuable tool when resourced and designed to meet needed requirements. As noted in this report, all members completed the only training required. With the addition of an independent legal counsel, other training will be developed to educate the Board members on California laws, regulations and codes as related to veterans’ affairs and open meeting procedures. The Board will also request the use of the resources available to the Office of Inspector General for assistance in meeting training requirements.

Plan of action: Appoint a training coordinator and develop a formalized training plan for the CVB.

7. The California Veterans Board should implement a follow-up system to trace the many recommendations made toward the Department of Veterans Affairs in previous audits.

Reply: The new leadership of the Department has identified the need to keep the Board informed on actions of the Department. The Board will ensure more detailed reports are requested with specific actions taken on each area of concern and address the recommendations noted to improve programs. It is clear that the expectation of the California Veterans Board as outlined in this audit are without adequate resources and staff to achieve. If this report reflects the intent of the California Legislation, then additional resources must be allocated to support the mission of the California Veterans Board.

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Agency's comments provided as text only.

Department of Veterans Affairs
Office of the Secretary
P.O. Box 942895
Sacramento, California 94295-0001

June 17, 2003

Elaine Howle, State Auditor*
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Attached is the Department of Veterans Affairs' response to your draft report #2002-120 entitled "THE CALIFORNIA VETERANS BOARD: *Without a Clear Understanding of the Extent of Its Authority, the Board Has Not Created Sufficient Policies and Provided Effective Oversight to the Department of Veterans Affairs.*"

The Department appreciates your review of the California Veterans Board and the opportunity to respond to the draft report. The Department disagrees with the report's recommendations regarding the recommendation to obtain outside counsel, and agrees with the recommendation regarding the Cal-Vet Home Loan Program. As pointed out in the draft report, steps are already being taken to comply. The attached response provides some clarification of audit findings.

If you require additional information, please do not hesitate to contact me, or Jerry Jones, Chief of the Farm and Home Purchases Division, at (916) 503-8318.

Sincerely,

(Signed by: K. Maurice Johannessen)

K. MAURICE JOHANNESSEN
Secretary

Attachment

* California State Auditor's comments begin on page 49.

RESPONSE TO THE BUREAU OF STATE AUDIT’S REPORT NO. 2002-120 – “CALIFORNIA VETERANS BOARD: *Without a Clear Understanding of the Extent of Its Authority, the Board Has Not Created Sufficient Policies and Provided Effective Oversight to the Department of Veterans Affairs*”

OVERVIEW OF THE REPORT

The California Department of Veterans Affairs (the department) has reviewed the findings, conclusions and recommendations presented in the above named report. As discussed in this response, the department will consider all recommendations and take appropriate action.

The Department appreciates your review of the California Veterans Board and the opportunity to respond to the draft report. The Department disagrees with the report’s recommendations regarding the need for the Board to obtain outside counsel.

Overall, the department agrees with the recommendations made in its two prior audit reports regarding the Cal-Vet Home Loan Program, and agrees with the recommendation in this report to continue to address the recommendations of the prior audits, especially the recommendation regarding the long-term viability of the Cal-Vet program.

As stated in a previous audit report, this is a complicated issue difficult to resolve “because future participation in the loan program is unpredictable for reasons that are out of the department’s control, such as federal eligibility restrictions and uncertainties over funding”. However, the Department is addressing these issues through its (and four other States’) efforts to effect passage of federal legislation to eliminate certain restrictions on QVMB funds, and is continuing to monitor its funding pools to determine if and when an alternative funding source may be necessary.

The department is aware of and understands the scope and methodology the audit team used to prepare the draft report.

THE FOLLOWING ARE OUR RESPONSES TO THE SPECIFIC FINDINGS AND RECOMMENDATION CONCERNING THE CALIFORNIA VETERANS BOARD.

FINDING:

The California Veterans Board is Not an Effective Policy-Maker for the Department of Veterans Affairs (Pages 9-13)

DEPARTMENT'S RESPONSE:

The audit report relies on an interpretation of state law regarding the power of the California Veterans Board as a policy-making body independent from the Department. The Department has always believed that the Board is a policy-making Board within the Department and has generally sought advice, not direction, from the Board on matters of public policy. The Board has, on occasion offered advice, and adopted policies in conjunction with requests from the Department. The audit findings regarding the performance of the Board demonstrate the essence of that practice.

The Department believes that the comparison of the California Veterans Board to the State Board of Education has more dissimilarities than similarities and is not a valid measure of the powers of the California Veterans Board. For example:

- In the Honig case, there are three separate statutorily constituted entities established with rule making powers. The California Veterans Board is established within the Department and has no administrative powers vested in statute.
- The State Board of Education is delegated powers by the legislature as a governing and policy-making board while the California Veterans Board is delegated only powers related to a policy-making board.
- There are no statutory requirements of when the California Veterans Board shall meet or how they will perform their duties. The Board has no administrative powers authorized by statute. The only explicit duty, hearing appeals, can be delegated to the Deputy Secretary level within the Department if the Board chooses to not hear appeals. There is a clear interdependency on the department unlike the State Board of Education duties.

The Department concurs that the California Veterans Board has ample authority to set policy regarding veterans affairs. The California Veterans Board members require an educational program to learn how policy making is done and the separation between administrative duties and policy-making pronouncements. The Board has no power to carry out, decide or impose administrative responsibilities on the department. The Department does not concur that the California Veterans Board is an entity independent from the authorities creating the department itself. The California Court of Appeals definition of policy-making (as stated on Page 9 in the audit) does not include the function of "control". The Department does not concur that the California Veterans Board has statutory authority to exercise control over the department as suggested on Page 12.

FINDING:

The California Veterans Board (CVB) has no independent counsel to provide legal advice on its responsibilities.

DEPARTMENT’S RESPONSE:

The department concurs with this finding. Please see the department’s response to the recommendation regarding the need for independent counsel below.

FINDING:

The Board’s methods of conducting appeals reveal its limited understanding of the procedures it should follow.

DEPARTMENT’S RESPONSE:

The Bureau of Audits determination that the CVB needs independent counsel when handling an appeal of a CDVA decision indicate both it and the Board have a misunderstanding of the Board’s function during an appeal and the CVB’s relationship to the CDVA.

When a veteran appeals a decision rendered against him or her by the CDVA to the CVB, the CVB file is sent to the CDVA’s legal office by the CVB Executive Officer. The Chief Counsel assigns the file to one of CDVA’s staff attorneys. The Chief Counsel does not instruct the attorney on what he or she is to find when investigating the matter. In fact, the Chief Counsel does not confer with the attorney handling the matter. The attorney is given a free hand to investigate the issue and determine whether to proceed or recommend dropping the case. Once the attorney determines to proceed he or she informs the Chief Counsel the case is going to hearing. The attorney is not asked any questions by the Chief Counsel regarding the matter.

At the hearing, the Chief Counsel hears the matter for the first time. The Chief Counsel rules upon any evidentiary questions arising during the hearing but does not vote when the case is submitted. In the proceeding the rules of evidence are relaxed and hearsay is admissible. The only parties who vote whether to sustain or deny the appeal are members of the Board. The Chief Counsel does not become involved in the decision making process. This particular approach to a hearing has been approved by the Court in the case of *Howitt v. Superior Court of Imperial County* (1992) 3 Cal.App.4th 1575, 76, 5 Cal.Rptr.2d 196, in which the Court stated, “Provided there is compliance with the proper guidelines, county counsel may be permitted to act as an advocate for one party in a contested hearing while at the same time serve as the legal adviser for the decision maker.” The Court further states “It should be sufficient if the lawyer advising the Board has no potential involvement in or responsibility for the preparation or presentation of the case.” This procedure has been termed the “Chinese Wall” defense (Words quoted from opinion). It is a recognized procedure that has been approved by the Courts for years. There clearly is no conflict between the Chief Counsel and the CVB when the former represents the CVB at an appeal hearing and rules on purely procedural issues that arise during an appeal hearing. The CVB is designed to be an independent administrative tribunal to adjudicate a dispute based upon the representations of the appealing veteran and the CDVA in an adversary proceeding. The appealing veteran has the right to independent counsel at these hearings should he or she so desire.

The Board is not empowered to investigate the facts of the appeal outside of the hearing. If the Board does conduct an investigation of the facts outside of the hearing, it goes beyond its power and becomes not a hearing body, but a participant in the proceeding denying both the veteran and the CDVA a fair and impartial hearing. The outside investigation of facts by the Board contaminates the entire appeal proceeding.

The Board is acting as a judge in the proceeding. A judge is not permitted to delve into the facts of the matter outside of the Courtroom. This was the intention of the legislature in giving the Board the right to hear appeals. The legislature did not give the Board any investigative authority because the legislature did not want the appeal process to become poisoned and the Board members to become investigators or advocates.

The Board hears the presentations of the parties to the appeal, is read the law on the matter (the same way a jury is instructed by the court) and retires to make its decision. Should the Board request clarification on the law governing the appeal, the Chief Counsel is there to assist it. The CDVA is not present to tell the Board how to rule on the submitted appeal. The legislature was clear as to the position the Board is to hold in an appeal. When the CVB follows the authority given them by the legislature both the appellant and the CDVA are afforded a fair and impartial hearing. There is no conflict of interest in the proceedings unless one of the parties exceeds the authority given it by the legislature. The procedure properly followed gives both the appellant and the CDVA a fair and impartial hearing. If the Board feels the facts presented by the CDVA attorney do not meet the requirements of the law to sustain the denial of benefits, it has every right and a total obligation to reverse the CDVA ruling.

The Bureau of Audits throughout its opinion viewed the Board as a separate legal entity from the CDVA with powers similar to the State Board of Education. Suffice it to say this is erroneous on its face as the Board was created as a part of the CDVA and its powers are very different than the State Board of Education. The CVB is not a governing body as is the State Board of Education. The State Board of Education was given this power when it was created by the legislature. The CVB was not given this power when it was created by the legislature. The legislature not only limited the power of the CVB when it created the CVB, the legislature also made it a part of the CDVA. The CVB has no power other than that conferred upon it by the legislature. The Bureau of Audits erred when it treated the CVB as a separate and distinct entity outside of the CDVA. This error permeates the entire audit. As the Bureau's basic concept of the CVB is wrong, so are the Bureau's recommendations regarding the necessity for independent counsel for the CVB. The CVB is a part of the CDVA and its aims and mission must be the same as the CDVA.

RECOMMENDATION:

To avoid the appearance of bias in its appeal decisions, the board should discontinue relying on the department's attorneys for legal assistance and using the department's chief counsel to preside over formal hearings.

DEPARTMENT'S RESPONSE:

There is no need for the CVB to have independent counsel because it is not in an adversary position to the California Department of Veterans Affairs (CDVA) when conducting business or when conducting an appeal hearing.

The parties in the case of the *State Board of Education v. Honig* (1993) 13 Cal.App.4th 720, 16 Cal.Rptr.2d 727, cited by the Bureau of Audits in their report justifying the Board's need for independent counsel misses the mark because the California Veterans Board is not an independent entity from the CDVA. It is a part of the CDVA. Military and Veterans Code, section 64 states, "There shall be in the Department of Veterans Affairs the California Veterans Board." [Emphasis added].

The *Honig* case involved three separate and distinct legal entities. These entities are (1) The State Board of Education, (2) the Superintendent of Public Instruction and (3) The Department of Education.

Section 33000 of the California Education Code provides, "There is in the state government a State Board of Education, consisting of 10 members, who are appointed by the Governor with the advice and consent of two-thirds of the Senate."

Article IV, Section 2, of the State Constitution reads

A Superintendent of Public Instruction shall be elected by the qualified electors of the State at each gubernatorial election. The Superintendent of Public Instruction shall enter upon the duties of the office on the first Monday after the first day of January next succeeding each gubernatorial election. No Superintendent of Public Instruction may serve more than 2 terms.

Section 33300 of the Education Code states, "There is in the state government a State Department of Education. Any reference to the Department of Education shall be deemed to be a reference to the State Department of Education, unless the context otherwise requires."

Each of these parties is a separate legal entity. None of them are a part of the other as stated by the Bureau of Audits. In view of the fact each of the parties to the lawsuit is a separate entity, each of them is entitled to independent legal counsel.

Since the CVB is a part of CDVA, it has the same aims, goals and mission as the CDVA "to protect and serve veterans." Why would counsel for the CDVA be in opposition to the CVB when both of them are part of the same entity? There is no inherent conflict between the CVB and the CDVA as there was in the *Honig* case. It was perfectly proper for the Court in *Honig* to draw an analogy between a Corporate Board of Directors and the Board of Education because both are separate legal entities. The Board of Directors is a separate legal entity from the company it oversees and the Board of Education is a separate legal entity from the Department of Education. The same analogy between the Secretary of the Department of Veterans Affairs and the California Veterans Board cannot be drawn as both are a part of the Department of Veterans Affairs. There is no similarity. An entity cannot be given more power and authority than that given by the legislature when it established the entity. The State Board of Education was established as a separate legal entity with the authority to govern and set policy for the Department of Education. The CVB was not made a separate entity from the CDVA nor was it given power to govern the CDVA.

In *Comite de Padres de Familia v. Honig* (1987) 192 Cal.App.3d 528, 532, 237 Cal.Rptr. 602, the Court held "Administrative regulations may not exceed the scope of authority conferred by the legislature." The CVB cannot be considered a separate legal entity outside of the CDVA when it is by creation a part of the CDVA. There simply is no inherent conflict of interest between the CDVA and the CVB as they are both a part of CDVA.

THE FOLLOWING ARE OUR RESPONSES TO THE SPECIFIC FINDING AND RECOMMENDATION CONCERNING THE CAL-VET PROGRAM.

FINDING:

Despite Implementing Many Recommendations We Made in Previous Audits, the Department Has Not Sufficiently Addressed An Important Issue for the Cal-Vet Program.

DEPARTMENT'S RESPONSE:

The Department agrees that the viability of the Cal-Vet program is an important issue and continues to address this issue through its (and four other States') efforts to effect passage of federal legislation to eliminate certain restrictions on QVMB funds, and is continuing to monitor its funding pools to determine if and when an alternative funding source may be necessary.

RECOMMENDATION:

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

DEPARTMENT'S RESPONSE:

The draft report cited 14 recommendations, 8 of which they considered implemented, 5 of which they considered partially implemented, and one of which they considered not implemented. The department agrees with the status identified for most of these items, as outlined in Table 3 on Page 4, titled "Status of Department Actions on Selected Recommendations From Previous Bureau of State Audit Reports," but would like to clarify a few of the items.

The first item on Table 3 refers to a partially implemented recommendation to maintain current demographic data necessary to identify the population of veterans eligible for, and likely to participate in, the Cal-Vet program. It refers to an expired contract for a data service that is used to obtain demographic data. The department would like to clarify that the process to contract for a new data service has been started. The Farm and Home Division is in the process of requesting approval of a multiple-year contract, and hopes to have a new contract in place with the successful bidder by December 2003.

The fourth item on Table 3 refers to a recommendation to adapt the Cal-Vet program to provide a home loan benefit to the greatest number of qualifying veterans for as long as possible. It refers to the department's efforts to change federal tax laws governing QVMB-backed loans, and cites similar efforts made in 1997 and 1999, which were unsuccessful. The Department would like to point out that these efforts were prior to the September 2001 tragedy and the recent war

in Iraq, which brought our country together on a wave of patriotism. The department believes that the current political climate is positive for passage of bills regarding veterans' issues, and is optimistic that HR1742, or a similar bill to be introduced in the U.S. Senate, will find sufficient support to become law. On a positive note, the five States have been contacted by the House of Representatives Ways and Means Committee for additional information – something that has not occurred in previous attempts to change the federal law.

This same item on Table 3 also refers to a high-level funding plan, which the Bureau feels does not include sufficient detail to sufficiently prepare the department for the potential loss of its QVMB funding source. The department agrees that the plan is broad and general at this time, and will continue to add details and specifics to the plan as our funding situation becomes more clear, particularly in regards to alternate funding sources and the future viability of the Life and Disability Program.

The department agrees that its primary responsibility is to ensure the health of the program overall. Every effort will be made to consider only options that have no adverse affect on the department's bond rating or assist one group of contract holders at the expense of another group.

Any long-term strategy will include consideration of the unpredictable variables of the aging population of 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, and the discontinuance of the insurance program for veterans newly entering the program. The department will use all available resources, including the sources recommended in the audit report.

COMMENTS

California State Auditor's Comments on the Response From the Department of Veterans Affairs

To provide clarity and perspective, we are commenting on the Department of Veterans Affairs' (department) response to our audit report. The numbers below correspond to the numbers we have placed in the margin of the department's response.

- The department is mischaracterizing our use of the *State Board of Education v. Honig* case. As the department correctly points out, there exist significant dissimilarities between the California Veterans Board (board) and the State Board of Education, yet the department's numerous attempts to state that we believe these entities are similar are false and misleading. Our discussion in the report on the *State Board of Education v. Honig* case is limited to a description of the relationship between a policy-making body (the board) and an administrative body (the department). On page 12 of the report we address the limited use of this case by stating that:

In addition, relevant case law from a dispute between the superintendent of public instruction (superintendent)—who is the director of the California Department of Education—and the State Board of Education addressed the question of whether the superintendent must follow the policies of the State Board of Education. The California Veterans Board and the State Board of Education are similar in that they are both established as policy-making bodies for their respective departments, and state law created both boards to work together with, rather than separate from, their departments. In its decision on this case, the state appeals court clearly indicated that the State Board of Education has authority over the Department of Education and that the Department of Education is subject to the State Board of Education's policies. Further, the court considered the relationship between the two entities similar to that of a board of directors and the corporation it oversees. Although the enabling statutes and the questions of this case may not perfectly address the California Veterans Board's authority over the

Department of Veterans Affairs, our legal counsel concluded that the statutes provide ample authority for the board to assert policy over the department.

The department concurs with this conclusion when it states “The Department concurs that the California Veterans Board has ample authority to set policy regarding veterans affairs.”

- In no place in our report do we suggest that the board can decide or impose administrative responsibilities on the department. Our definition of policy-making is based on the California Court of Appeal definition listed on page 11. Further, we acknowledge on this same page that: “Although the distinction between *policy* and *administration* is not always clear, *policy* generally refers to the goals or objectives of an agency, while *administration* refers to the specific day-to-day means of achieving those goals or objectives.”
- The department is mischaracterizing the content of our report. On page 16, we state “These instances create the appearance that the board is not in a position of control and clearly indicate a need for the board to exert its authority over the department.” As we state on pages 11 and 12 of the report, the board should not involve itself in the day-to-day operations of the department. However, California law gives the board far-reaching authority as the policy-maker for the department’s programs and in this context, the board should be in a position of “control” when it sets the goals and objectives of the department.
- We agree that the board has a limited understanding of the appropriate procedures to follow when conducting appeals. In light of the important property interest that a veteran may have in veterans’ benefits, and the well-recognized public policy goal of veterans’ rights to those benefits, we consider it important for the board to have a clear understanding of the appropriate procedures to follow when hearing appeals and to have access to independent counsel to provide advice on those procedures.
- As our report indicates, we question whether the potential involvement by department legal staff in the initial decision-making process and their involvement in the appeal, as well as the participation by the department’s chief counsel in the appeals process are advisable. Thus, as noted on page 19, we suggest that by using independent counsel “the board could avoid the appearance of partiality that might arise” in these instances. In addressing any potential bias that may exist on the part of legal counsel, the courts have been particularly concerned

about potential violations of due process that may occur when an attorney who acts as an advocate or decision maker at one level of the adjudicatory process has an opportunity to further influence the decision-making process by advising those who consider an appeal of that issue (*Nightlife Partners Ltd. v. City of Beverly Hills* (2003) 108 Cal. App. 4th 81). However, in raising this concern, we reach no definitive conclusion on the legality of the involvement of the department's legal staff and chief counsel in the board's appeal process, but instead point out that the board could avoid the appearance of partiality by using independent legal counsel to assist it with veterans' appeals.

● The department's statement mischaracterizes our report as suggesting that we view the board and the department as separate legal entities, thereby creating the need for each entity to have separate legal counsel. In reaching our conclusions, we were aware that the provisions of law governing the board plainly state that it has been statutorily created as a policy-making body within the department. The fact that the board is created within the department does not eliminate the need for the board and the department to have independent counsel when conflicts arise. Indeed the board and the department have separate and distinct legal responsibilities, which even the department recognizes in its response may create potential conflicts. The most obvious of these is the board's statutory responsibility to hear appeals by veterans of decisions made by the department and the power to change or modify with good cause any decision that is adverse to the veteran. In view of the potential conflicts that may arise when the board turns to department legal staff when hearing an appeal, our report merely suggests on page 19 that the board could avoid the appearance of partiality that might arise under those circumstances if it had independent counsel advising it on the appeal. To address the department's concerns that the statutes establishing the State Board of Education and the board are worded differently, we modified the text on page 12 to read "The California Veterans Board and the State Board of Education are similar in that they are both established as policy-making bodies for their respective departments, and state law created both boards to work together with, rather than separate from, their departments." However, this does not change the basis for our conclusions or recommendations.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press